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Politics this week

Jun 18th 2009
From The Economist print edition

Getty Images

A crowd of around 1m people marched through Tehran, **Iran's** capital, to protest against what the demonstrators said was a rigged election that enabled Mahmoud Ahmadinejad, the incumbent president, officially to beat the reform-minded Mir Hosein Mousavi, by a margin of two to one. Similar protests occurred in other towns across the country. The police cracked down, shooting some demonstrators and arresting scores of dissidents and reformers. As the protests continued, the ruling clergy said there would be a partial recount. See article

Israel's prime minister, Binyamin Netanyahu, accepted that the **Palestinians** should have a state alongside Israel, but most Palestinians and Arabs derided the shift because of the conditions he attached to it. Barack Obama, who had recently told Mr Netanyahu to make the move, gave it a cautious welcome. See article

In south **Sudan** gunmen from the Jikany-Nuer tribe looted a big UN aid convoy to prevent food supplies from reaching another Nuer group. About 40 guards who used to belong to the Sudan People's Liberation Army, the main former rebel group in the south, were killed in the attack. Hundreds of people have died in inter-tribal fighting in recent weeks.

The police chief in **Somalia's** capital, Mogadishu, was killed by Islamist militias fighting against the fragile government.

The rate at which the world's **refugees** returned home slowed sharply last year, said the UNHCR in a report. The net total number of uprooted people fell slightly, to 42m.

Exiting the valley?

India's government announced that it wanted to withdraw troops from the inhabited areas it controls in the divided region of **Kashmir**. Hundreds of thousands of troops are stationed in Kashmir, which has suffered two decades of insurgency. India's home minister said he hoped to make the police responsible for internal security, but gave no timetable.

Maoist Naxalite rebels in **India** claimed to have "liberated" an area in the state of West Bengal, seizing control from the local government.


AP

Meeting on the margins of a regional summit in Russia, **Pakistan's** president, Asif Zardari, and **India's** prime minister, Manmohan Singh, held talks about renewing the two countries' formal talks. No agreement was reached. Mr Singh reiterated India's concern about Pakistan's role as a base for cross-border terrorism.

Pakistan said it was massing forces in the tribal area of South Waziristan, in readiness for an offensive against Baitullah Mehsud, the leader of the **Pakistani Taliban**.

A court in **Indonesia** sentenced Aulia Pohan, a former deputy governor of the central bank, to four and a half years in jail for approving illegal payments to politicians. The case attracted great interest because Mr Pohan's daughter is married to the son of the president, Susilo Bambang Yudhoyono.

South Korea's president, Lee Myung-bak, met Barack Obama in Washington. Both men reaffirmed their countries' alliance and opposition to **North Korea's** nuclear capability; the North threatened a "thousandfold" retaliation if attacked. Earlier, the UN Security Council voted unanimously to toughen sanctions against North Korea. See article

Preventing voter apathy

Canada seemed to have averted the threat of its fourth general election in five years when Michael Ignatieff, the leader of the Liberals, the largest opposition party, agreed to back Stephen Harper's Conservative minority government in a confidence vote.

Peru's government said it would repeal two decrees facilitating investment in the Amazon jungle, after two months of protests in which 24 police and perhaps 30 Indians died. Yehude Simon, the prime minister, said he would resign once calm was restored. The foreign minister called **Bolivia's** president, Evo Morales, an "enemy of Peru", after he described the deaths of the protesters as "genocide" in the name of free trade.

Britain complained to the United States that it was not consulted about a deal under which four men held at Guantánamo Bay were sent as refugees to **Bermuda**, a British territory. Hundreds of locals demonstrated against the decision to admit the men, all Uighurs from western China. The Uighurs went fishing.

Prisoner exchange

Italy agreed to take three detainees from Guantánamo. Italy's prime minister, Silvio Berlusconi, made the offer to Barack Obama at a meeting in the White House.

Russia vetoed the extension of a UN observers' mandate in **Abkhazia**. It had already ejected monitors in South Ossetia from the Organisation for Security and Co-operation in Europe. There will now be no international observers inside the two Georgian territories, whose independence Russia recognised after last August's war with Georgia.

Gunmen shot dead a policeman guarding a witness in a terrorism trial in **Greece**. A leftist group, the Revolutionary People's Struggle, is at the centre of the trial.

In **Northern Ireland** more than 100 Romanians, mostly Roma (gypsies), fled their homes in south Belfast after a spate of racist attacks. The deputy first minister, Martin McGuinness, called the attacks a "totally shameful episode".

AFP

Do no harm

Barack Obama gave a speech to the biggest doctors' lobby in America, in which he urged it to back **health-care reform**. The American Medical Association has said that it will oppose any public plan "that forces physicians to participate". The Senate began debating the first health-care proposals to emerge from committee. See article

Mr Obama signed an order that extends benefits to the **same-sex partners** of federal employees. Health insurance is not included, provoking more criticism from gay groups that the president is not fulfilling his promises to them.

A judge allowed a civil lawsuit to proceed against John Yoo, an official in the Bush administration who helped form policy on the treatment of suspected **terrorist detainees**. José Padilla, an American citizen who has been sentenced on terror conspiracy charges, is suing Mr Yoo for $1 and for an admission that his incarceration as an enemy combatant was unconstitutional.

Business this week

Jun 18th 2009
From The Economist print edition

The Obama administration announced the most sweeping changes to **America's financial regulatory system** in decades. In a white paper it proposed greater authority for the Federal Reserve, enabling the central bank to supervise all systemically important financial firms, supported by a multi-agency council; powers for the federal government to seize and dismantle large distressed companies; tougher rules on derivatives and securitisation; and a requirement for hedge funds to register with regulators. A new agency will be formed to bolster consumers' rights. Congress will deliberate over the plans. See article

Mervyn King, the governor of the Bank of England, and Alistair Darling, the chancellor, struck different tones on **banking regulation** in twin speeches to City executives. Mr King said Britain's central bank needed more power to discharge its regulatory responsibilities, as it could now do no more than "issue sermons or organise burials". See article

The European Central Bank said that losses at banks in the **euro area** could increase by $283 billion by the end of 2010. It predicted big problems for banks that are undercapitalised or overexposed to potential economic instability in central and eastern Europe.

American Express, Goldman Sachs, JPMorgan Chase and Morgan Stanley were among ten financial companies to repay the loans they received from the **Troubled Asset Relief Programme**, after being given permission by the Treasury to leave the scheme.

Shake your money-maker

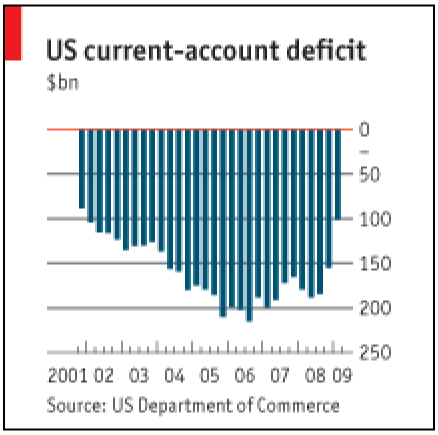
Barclays accepted **BlackRock's** offer to buy **Barclays Global Investors** for $13.5 billion. The combination of BGI, which is based in San Francisco, and BlackRock creates the world's biggest money-manager, with around $2.8 trillion in assets under management. See article

Sumitomo Mitsui Financial Group launched a share issue to raise capital. The Japanese bank hopes to bring in ¥923 billion ($9.6 billion), the biggest public offering in Japan for several years.

After finding buyers for its Hummer and Saturn brands, **General Motors** entered an agreement to sell its **Saab** division to **Koenigsegg**, a tiny maker of high-performance cars based in Sweden. The deal is tied to a $600m loan backed by the Swedish government. Koenigsegg's claim to fame is building a car that reportedly picked up a speeding-ticket in America when it was clocked at 242mph (389kph). See article

Good news, sort of

America's **current-account deficit** dropped sharply in the first quarter, to $101.5 billion (or 2.9% of GDP), its lowest level since the last quarter of 2001. The main reason was the steep decline in imports, particularly oil and oil products and industrial supplies and materials.



FedEx posted a large quarterly loss and delivered a gloomy forecast of its prospects for the rest of the year. The company is considered a guide to the American economy because it ships everything from property documents to car parts.

In the latest effort to cut costs at **airlines**, British Airways asked its staff to volunteer to work for nothing or take unpaid leave for up to a month to help the company's "fight for survival". Air India, meanwhile, deferred payments to its employees for two weeks because of a cash crunch. See article

MySpace laid off 30% of its staff in America. Viewership and advertising at the website have declined as it has ceded its once-dominant position among online social networks to Facebook.

Hollywood players

Screen Digest reported that despite a huge increase in sales of **Blu-ray discs**, total sales for the global film-disc business fell by 4.8% last year. The media-analysis firm said the home-entertainment industry's hope for a revival in fortunes had been undermined by Blu-ray's "format war" with HD DVD, which impeded the kind of market shift seen in the switch from video to DVD.

Lord Rogers, an architect whose works include the Lloyds building in London, complained that his modernist redevelopment plan for the site of a former barracks in central London had been scuppered by interference from Prince Charles, who waged a private campaign for an alternative classical design. The site was bought for £1 billion ($1.6 billion) by Qatar's property-investment arm, which is resubmitting the plans. The prince's building trust said it would participate in a "more open" process.

Six Flags filed for Chapter 11. Revenue has plunged at the company, which owns 20 amusement parks. It needs to restructure around $2 billion of debt that it hopes will allow it to leave bankruptcy protection soon. A new ride to pull in the summer crowds at its Magic Mountain theme-park could also help: its name is Terminator Salvation.

KAL's cartoon

Jun 18th 2009
From The Economist print edition

Illustration by KAL

Iran and the world

Iran rises up

Jun 18th 2009
From The Economist print edition

It looks increasingly as though the government will have to crack down or back down

AP

THE sight of a million-odd demonstrators on the streets of Tehran, the like of which has not been seen since the revolution that unseated the shah in 1979, is bound to stir the hearts of freedom lovers the world over. That is especially true when the chief butt of popular anger, President Mahmoud Ahmadinejad, is a Holocaust-denying bully who seems bent on getting his hands on a nuclear weapon. Yet outsiders tempted to shout their support for the protesters should tread carefully for fear of achieving the opposite of what they intend.

After holding the country in a tight grip for 30 years, Iran's clerical rulers are in disarray. The presidential candidate who was supposed to have come second in last week's ballot, Mir Hosein Mousavi, seems likely, judging by all the chicanery, to have won (see article). The establishment is divided, with some stalwarts of the revolution siding with the demonstrators. Even the supreme leader, too spiritual to submit himself to popular ballot for the near-omnipotent post he has held for the past two decades, has become embroiled in the squalid electoral fray. He may ultimately even face the question of his, and the regime's, survival.

No one can see into the back rooms of the clerical establishment or into the bunkers of the Revolutionary Guard. No one knows the real results of the vote. No one can predict how long the street protests will last or how ready the regime is to use force and the price it would pay in its own people's blood. Yet something momentous has happened in a pivotal country in the most combustible part of the world. Having fatally misread its own people, Iran's government must now decide whether to back down or to crack down.

The judgment of history

Iran is the fulcrum of an unstable region. If it behaved responsibly, the world would naturally look to it as the local power. Instead it meddles, often malevolently, with its neighbours.

That is not surprising, for it has been the victim of much meddling. The country has been buffeted between imperial rivals—Russian, Turkish, British and American—for more than a century. The West once took Iran's oil for itself. Britain and America sabotaged its brief experiment with democracy in 1953, as Barack Obama admitted in his admirable speech to Muslims in Cairo earlier this month. A generation ago Iran was assaulted by an Arab army headed by Iraq's Saddam Hussein, leaving a million dead. Persian prickliness,

even paranoia, is understandable. Iran feels ringed by the forces of what it sees as its main enemy—America. The eagerness of Iran's rulers for a nuclear capability, which they swear is only for civilian use but which most outsiders reckon would lead inexorably to a bomb, is shared by nearly all Iranians, even those on the streets, as a national birthright in a hostile world.

But an external threat cannot justify the crass debauchery of the presidential poll. Iran is not a democracy, but its system, which combines unelected religious authority with a subordinate elected civilian one, was designed to give people a chance to let off steam from time to time within carefully set electoral limits. And today there is a head of steam to vent. The young are bored and rebellious and short of work, women are oppressed, bazaaris fed up with economic bungling. Even some clerics reject Mr Ahmadinejad for his populist brand of Islam.

For this election, the limits were set very narrow. The supreme leader, abetted by largely unelected councils, allowed just four out of more than 400 candidates to face the voters in the presumption that his populist incumbent protégé would stroll to victory. Instead those disparate groups of discontented Iranians united behind the main challenger, Mr Mousavi. The ballot-rigging turned that support into a mass protest against the system itself. Given that all four official candidates were sworn to keep the largely theocratic system going, the government's performance was stupid as well as pernicious.

Iranian demonstrators are a determined lot. Before the shah's fall, protests went on for months. But what happens now will be decided as much by the depth of divisions within the ruling clerical establishment as by the stamina of angry crowds. The clerics are faced with a desperate dilemma. By letting air into a system that has stifled even basic freedoms, yielding to the demonstrators could undo the regime; and yet to use force risks turning Iran into any other cheap dictatorship. A regime that has long sought to claim both legitimacy and a monopoly on power may soon have to choose which of the two it most desires.

The best of all possible worlds

Watching Iranians pour onto the streets to demand change, those in the outside world who wish Iran well must hope fervently that it comes. Iranians are too sophisticated to be ruled for ever by a clutch of old men in turbans. The regime has been illiberal and authoritarian. It is often vicious in its suppression of opponents and its disregard for human rights. Iran has the highest rate of judicial executions per head in the world. Women are second-class citizens. Even so, Iran is nothing like the totalitarian, mass-murdering regimes of the Soviet Union or Nazi Germany. However many votes he rigged, Mr Ahmadinejad has a big constituency behind him.

The West must tread carefully—as Mr Obama has done (see article)—in its response to Iran's unfolding crisis. It should condemn abuses of human rights and electoral malpractice, but it should avoid taking sides. Given Iranians' understandable hostility to outside interference, endorsing Mr Mousavi would only strengthen Mr Ahmadinejad. And whoever ends up running Iran, the West will have to talk to its leaders about its nuclear programme.

A new president and a kinder regime in Iran would be a valuable prize. It would lower the regional temperature. In Iraq, where Iran meddles, blood is still being copiously spilt, albeit far less so than a few years ago. In Palestine and Lebanon, both zones of Iranian interference, it could help tilt the protagonists towards compromise. It could even improve Afghanistan. So, as Iran splutters and seethes, the world must watch and wait—and keep its offer of goodwill on the table.

Israel, Palestine and America

Both states must be real

Jun 18th 2009
From The Economist print edition

Binyamin Netanyahu has taken one essential step. Now he must take a whole lot more

AP

ISRAEL'S prime minister has at last accepted that a Palestinian state must exist alongside an Israeli one if there is to be any chance of a durable peace between Arabs and Jews in that tragic sliver of land that three great faiths consider holy. In a much-heralded speech meant to answer Barack Obama's ringing re-endorsement of a Palestinian state in Cairo ten days earlier, Binyamin Netanyahu spat out the required pair of words. They were welcome; but unless he shows a greater readiness to negotiate in good faith, his belated move will turn out to be pointless.

Mr Netanyahu hedged his acceptance of two states with conditions, promises and evasions. He turned a deaf ear to Mr Obama's demand that the building and expansion of Jewish settlements on the land that must become part of that Palestinian state must stop. Despite the fact that Arab citizens of Israel make up a fifth of the population, he demanded, as a new precondition for negotiations, that the Palestinians must acknowledge Israel as a Jewish state, which is code for their renouncing in advance the right of any Palestinian refugees to return to Israel. He insisted on a series of curbs and limitations on a putative Palestinian state that would deprive it of sovereignty. He said that Jerusalem, which the Palestinians want to be a shared city and capital of their new state, must stay united under Israeli control. Mr Netanyahu, who opposed the withdrawal of Israeli troops and settlers from the Gaza Strip four years ago, made no hint that he would hand back any Palestinian territory that might make Israel's border less "defensible".

As his shift on two states shows, Mr Netanyahu is not wholly immovable. Some of his conditions—say, over the degree of demilitarisation of a Palestinian state—are likely to be open to negotiation. On other areas, Mr Obama must keep pushing him. His intransigence over the settlements cannot be allowed to stand. Mr Obama should intensify his rhetoric, even threatening to withhold some financial and technological aid, if the Israeli leader refuses to budge.

Mr Netanyahu, of course, is under pressure from coalition partners even more hawkish than himself. Some of them are annoyed by what they regard as his truckling to Mr Obama. But they are not the only possible partners for him. If they walked away, he could try to bring on board Tzipi Livni, leader of the centrist Kadima party, who won Israel's general election earlier this year but failed to form a ruling coalition precisely because Mr Netanyahu refused to countenance the two-state idea. Ms Livni's co-operation might improve matters all round.

The gulf

At the same time, there is work for Mr Obama to do on the other side. Rifts in the Palestinian movement are so deep that even the best-intentioned Israeli government would find it hard to strike a two-state deal that would stick. Mr Obama, with help from friendly Arab countries such as Saudi Arabia, Egypt and Jordan, should strive to bring the Palestinians together, in the hope that the rejectionists of Hamas, the Islamist movement that has so far refused to recognise Israel, should be drawn into negotiation. It may be doable: Hamas's leader gave rare if grudging approval to Mr Obama's sweet words in Cairo, where America's president acknowledged that "some Palestinians" supported it and urged it to join the diplomatic fray.

The gap between Israelis and Palestinians remains wide. While Israel's leader refused to accept the two-state idea, it was unbridgeable. The Palestinians cannot and should not accept the sort of state that Mr Netanyahu is offering. But he has conceded a huge point of principle, and given Mr Obama something to work on.

Economist.com OPINION LEADERS

Argentina's mid-term election

A chance to change course

Jun 18th 2009
From The Economist print edition

The Kirchners' economic nationalism is leading their country down a blind alley

Reuters

IT IS only a mid-term election, for half of the lower house of Congress and a third of the senate. But when Argentines vote on June 28th much more than that is at stake: the power and perhaps even the permanence of the first couple, Cristina Fernández and Néstor Kirchner, her husband and predecessor as president. By choosing to run for the lower house himself in the province of Buenos Aires, Mr Kirchner has deliberately turned what might otherwise have been a routine affair into a referendum on himself, his wife and their ideology of state-led economic nationalism.

Mr Kirchner gives warning that a vote for the opposition would mean that "jobs will vanish, the poor will fall back, a frightening past will return." In fact all these things are happening already and the Kirchners must take some of the blame. The election is a chance to stop the first couple from leading Argentina further down its sad path of decline.

When he took office in 2003 Mr Kirchner inherited a country laid low by economic and financial collapse, which had seen a president chased from office by rioting mobs and a massive debt default. Although this was the result of policy mistakes and global financial instability, Mr Kirchner preferred to blame it on "neoliberalism". But he was lucky, inheriting from his interim predecessor a competent economy minister and macroeconomic policies that had restored stability. With the world hungry for Argentine grains, the country enjoyed six years of economic growth averaging 8%. Grateful voters rewarded him by electing his wife in 2007, amid heady talk of a long reign for the first family.

Some of Mr Kirchner's actions—such as an expansionary fiscal policy and help for debtors—represented emergency pump-priming of a kind now familiar around the world. But he made them permanent, mortgaging his country's future. To sustain them, the government has taxed Argentina's efficient farmers into the ground. Last year Ms Fernández nationalised the private pension system. Foreign investors in privatised utilities have been harassed, deterring others. Brazil is supposedly Argentina's partner in a customs union, but its exports face a host of barriers.

Shown up by the neighbours

Now Argentina has followed the world into recession and it is ill-placed to respond. Official figures show only a mild downturn and low inflation, but they are worth little: Mr Kirchner put stooges in the statistics office and they massage the numbers. In fact, tax revenues and real wages have plunged. Fears of another

debt default may be exaggerated—for the time being. But inflation is unofficially at 15%. And the Kirchners' refusal to settle with private creditors and their hostility to the IMF leave Argentina with few sources of credit.

This rapidly darkening outlook is why Ms Fernández brought forward the mid-term election, due in October. Her husband's resort to campaign stratagems also smacks of desperation. The signs are that she will lose her majority in the lower house of Congress. Mr Kirchner may not top the poll in Buenos Aires. They face a reviving opposition, and a revolt from within the ruling Peronist party (see article).

The infantile solipsism that leads a government to fiddle the economic figures has been the handmaiden of decline. It is writ large in the populist nationalism that has been a thread in Argentine policy since the days of Juan Perón in the 1940s. A century ago Argentina was one of the world's ten richest countries. As recently as the 1960s it prided itself on being the most prosperous and important country in Latin America. Now its neighbour Brazil is bracketed with the world's leaders, while Argentina trails. Argentines should note that Brazil's centre-left government has espoused fiscal prudence and free trade and welcomed foreign investment. Measured by purchasing-power, Chile has overtaken Argentina in income per head. Even tiny Uruguay now exports more beef than its neighbour across the River Plate—thanks partly to big investments by Argentines who like its commitment to the rule of law. Long the best-educated people in South America, Argentines now trail Chileans and Brazilians in international tests.

Despite its long history of bad governments, Argentina still has much going for it. The world needs its farmers, and tourists like its culture. But it needs freer trade, fiscal responsibility and greater respect for the rule of law.

The election may help move Argentina in that direction. It could present a credible alternative to the Kirchners. It may provide a more independent-minded Congress, which could oblige Ms Fernández to start ruling in a more consensual manner. Argentines should use their votes to bring that about.

Economist.com OPINION LEADERS

Reforming financial regulations in America

Better broth, still too many cooks

Jun 18th 2009
From The Economist print edition

Barack Obama's plan for regulatory reform is not bold enough

AFP

FINANCIAL regulation in America has two problems: there is both too much of it and too little. Multiple federal agencies oversee the financial system: five for banks alone, and one each for securities, derivatives and the government-sponsored mortgage agencies. They share these duties with at least 50 state banking regulators and other state and federal consumer-protection agencies. Yet all these regulators failed to anticipate and prevent the worst financial crisis since the Depression, because risk-taking flourished in the cracks between them. Toxic subprime mortgages were peddled by lenders with little federal oversight and shoved into off-balance-sheet vehicles. The greatest leverage accumulated in firms that avoided the capital requirements of banks.

On June 17th Barack Obama took aim at these weaknesses (see article). His financial white paper gets much right. First, it does not pursue what Dan Tarullo, one of the governors of the Federal Reserve, has called "reform by nostalgia". Rolling back the deregulation of the past three decades would have wiped out the genuine benefits that innovation and competition have brought to Americans. Second, it recognises that many remedies do not require new regulators, but simply better regulations, such as beefed-up capital and liquidity buffers for banks and shifting much of the "over the counter" trade in derivatives to regulated exchanges and clearing houses.

In other respects the plan does not go far enough. It does too little to reduce the multiplicity of regulators that has long undermined their effectiveness. To be sure, regulatory competition is not all bad: it can check government overreach and nourish experimentation. Nor is a unified regulator a cure-all: Britain's Financial Services Authority failed to do anything about British banks' excessive dependence on short-term, wholesale funding. But most of America's overlap is a useless holdover from the days when commercial and investment banks, thrifts, government-sponsored enterprises and commodity dealers did different things. This overlap encourages dodgy firms to shop around for the friendliest regulator, which is how the Office of Thrift Supervision (OTS) ended up overseeing so many big, failed companies. It slows down implementation of new rules, breeds turf wars, corrodes accountability and increases costs.

But under the new proposals only one agency, the OTS, will disappear. A new agency to protect consumers will take this area over from the bank regulators. But it will not assume similar duties now held by the Securities and Exchange Commission or Commodity Futures Trading Commission, and have little enforcement authority over thousands of state-regulated finance companies and loan brokers—a glaring shortcoming given that such firms were responsible for originating a large share of toxic mortgages and abusive loans.

The plan also complicates the role of the Federal Reserve, which has already been exposed to political attack by its unprecedented interventions in markets and the economy. The Fed should certainly revisit how it does its job. The financial crisis has amply demonstrated that maintaining low inflation does not guarantee economic stability. This has fired up interest, in Europe as well as America, in “macroprudential regulation”: the notion that regulators must supplement “micro” supervision of individual firms by looking across entire markets and industries for risks that threaten the whole system.

This is much harder in practice than in theory. By its very nature, risk-taking thrives in the shadows and crises take regulators by surprise. But if macroprudential regulation is to be done, the central bank is the logical body to do it. As lenders of last resort central banks pick up the bill in systemic crises, so they deserve a role in preventing them. The European Union is also proposing that European central bankers work with bank supervisors to detect and prevent systemic risk. Unlike the EU proposals, however, Mr Obama’s plan also makes the Fed directly responsible for the supervision of all firms deemed too big to fail in addition to its existing responsibility for bank holding companies and some banks. That introduces conflicts of interest and risks of regulatory capture: might the Fed be tempted to bail out a firm to save jobs, for example, or refrain from raising interest rates to stop a big firm from failing? If the Fed is to receive this expanded macroprudential role, it should be stripped of its microprudential duties.

Don’t let a crisis go to waste

Mr Obama’s aides have concluded that a more ambitious overhaul of America’s sprawling regulatory system would expend too much political capital with too little benefit. That bodes poorly for their willingness to face down special interests over the details of even this limited proposal. Who will have to hold more capital, and how much? Which firms will be designated as systemically important, and how will they pay for their implicit government backing? How to prevent banks shopping around for laxer rules abroad? Mr Obama’s aides are famously fond of saying that crises create opportunities. But the best opportunity in years for a complete redesign of America’s regulatory apparatus seems to be going to waste.

Economist.com OPINION LEADERS

Fund management

Competitive failure

Jun 18th 2009
From The Economist print edition

Mergers between fund managers will not bring fees down. Customers could

Illustration by Claudio Munoz

ECONOMISTS tend to think that an industry divided between hundreds of players, each with a tiny market share, should be fiercely competitive, with prices cut to the bone. But economic theory struggles to explain the bizarre world of fund management, where the market is fragmented but fees stay stubbornly high.

The takeover of Barclays Global Investors (BGI) by BlackRock, finalised on June 16th, will create the world's largest asset manager. More deals are likely in the coming months. In part that is because banks are keen to shed their fund-management arms, either because they need to raise capital or because they no longer see a business case for combining deposit-taking with portfolio management. In part it is because stockmarket falls in 2008 slashed fund managers' revenues, leaving some groups with broken business models. But the industry remains massively diffuse and has defied past predictions of consolidation. Even the BGI/BlackRock deal will create a fund manager with only 3-5% of the global market. Perhaps the problem is that the industry has difficulty generating economies of scale. Might a few mergers be good news?

Bigger does not necessarily mean better when it comes to running other people's money. True, a bigger group has more money to spend on marketing and can achieve economies of scale in areas such as back-office technology and administration. But there are also disadvantages of scale. Large funds are less flexible and tend to move prices against them when they trade; they also tend to be more bureaucratic and end up alienating talented managers, the ones clients want to look after their money. Luck also plays its part. Fund managers may grow for a while because of superior investment performance. But sooner or later they will be undone by a change in market fashion; their performance will deteriorate and hot money will move elsewhere.

The BGI/BlackRock deal may avoid some of these problems. BGI is one of the two biggest fund managers in the field of index-tracking, one area where having more funds under management does lead to lower costs, which in turn makes it easier for the manager to match a chosen benchmark. But that is something of a special case. The general rule of fund-management consolidations is that they may be a good deal for the companies, but they rarely bring much benefit to investors, for two reasons. First, retail fund managers compete on past performance rather than price. Alas, a good performance one year tends not to be repeated the next; but the fees carry on. Second, because of their inertia, retail investors tend not to buy funds; funds are sold to them. Fund managers must pay banks and brokers to distribute their products, and they claim back that money from investors. As a result the bestselling funds often have the highest charges; other things being equal, they represent the worst deal for investors.

The price is wrong

That second factor helps explain why there is a stark difference between America and Europe. In America, where retail investors are more willing to buy funds directly, the expense ratios of mutual funds have declined for four successive years, according to Lipper, a provider of financial information. But in Europe, where funds are largely sold through banks, annual management fees have steadily risen, from 1.3% in 1994 to 1.6% last year. Retail fund-managers have fed themselves well, but their investors have been left with the scraps.

Even institutional investors such as pension funds and insurance companies, which ought to have the clout to force down fees, are paying more. A survey by Watson Wyatt, a consulting firm, found that the cost of running a pension scheme increased by around half between 2003 and 2008. That was because schemes allocated more of their portfolios to hedge funds and private-equity managers, which charge much higher fees. Chasing performance by paying higher fees might work for individual investors, but in aggregate it is doomed to fail. The return to the average investor is the market return minus costs; if costs rise, returns must fall.

Retail investors, in particular, would do well to learn that lesson, and take responsibility for their own finances. Just as they shop around to find the best estate agent, they can seek out low-charging vehicles such as exchange-traded funds. If enough investors focus on cost, not performance, the fund-management industry will have to give them a better deal.

Business in Japan

No exit

Jun 18th 2009
From The Economist print edition

What Japan needs is more bankruptcies, not fewer

Illustration by Claudio Munoz

JAPAN has long practised a form of familial capitalism. In good times industrial collusion, overseen by bureaucrats, is practically official policy. The so-called "convoy system" lets corporate stragglers retain a small market share as bigger and better firms steam ahead. For decades this cosy form of capitalism ensured that competition was never too fierce and everyone prospered at least a bit. It certainly smoothed out the occasional ups and downs during the country's stunning post-war economic development, as it rapidly caught up with the West. So it is not surprising that many politicians and business leaders are advocating an even stronger dose of such medicine now. As Japan struggles with its deepest recession since the war, the government has established a mechanism to give financial help to poorly performing firms, companies are being encouraged to provide support to their weaker suppliers, and banks are being asked to do their bit, too.

There is nothing unusual about any of this, you might say. Governments around the world are racing to protect their cherished, if dented, national champions. Financial institutions and carmakers have been bailed out in both America and Europe. But in the West such assistance is the exception; in Japan it is central to the system. The problem is that keeping ailing companies on life-support holds back healthier firms and harms the economy overall. That is true everywhere, but Japan provides an extreme case that illustrates the dangers of coddling weak companies.

Japan's stronger firms have responded relatively quickly to the recession, in marked contrast to the dithering during the "lost decade" of the 1990s. It is still unclear whether they have done enough (see article). But it is certain that efforts to keep their struggling rivals afloat are hurting them.

Politicians, having been unwilling to push through painful structural reforms in relatively good times, are even more reluctant to put forward tough measures when times are bad. Banks are being pressured by the government to roll over existing loans and make new ones, and firms encouraged to extend credit and maintain business relations. The government's recent stimulus measures give failing firms taxpayers' money. A plan approved in May allocated ¥2 trillion ($21 billion) to prop up (indirectly) troubled companies. Pioneer, an electronics firm, Elipda, a chipmaker, and Japan Airlines are among the first to look for government support.

All of this does enormous harm. Weak firms need to exit the market, either by going bust or being sold to another firm, or the whole business environment gets stifled. Japan has far too much capacity in many businesses—eight mobile-phone makers, for instance, few of which make much money. This squeezes

prices and margins, thus denying better-run firms the surplus capital they need to hire talented people, buy competitors or invest in research and development. It also locks up resources, both human and financial, that could be used more productively by stronger firms. Before the downturn, Japanese companies' return on equity averaged around 10%, about half the level of American firms.

Tellingly, the shut-down rate of companies in Japan is around half that in America and Britain. And the number of corporate insolvencies is expected to increase in Japan this year by only 15%, despite the depth of its recession, compared with more than 30% in western Europe and 40% in America. Normally a scarcity of corporate bankruptcies is a sign of economic vitality; in Japan, it is a sign of its economic weakness. Of course, keeping struggling firms alive protects jobs. But it also fossilises industry structures and hinders the development of a more flexible labour market and a business environment more supportive of new-company creation—two areas where Japan is also sadly deficient.

And the zombies march on

With a general election due to be called by September, in which a new political party may take the reins of government after more than half a century of almost uninterrupted rule by the Liberal Democratic Party, no one has said a word about reforming the economy to introduce more competition in more industries. But this should be on the agenda. During its post-war boom Japan built its reputation on the back of innovative products and fastidious quality; it has since become better known for zombie companies.

As governments around the world come under pressure to bail out everything from retailers to travel companies to automotive firms, Japan's experience—a downturn followed by years of stagnation—serves as a reminder of the importance of destruction in capitalism. Instead of continuing to prop up struggling companies, Japan and other countries need to let them go under, so that new, better ones can be created.

Economist.com OPINION LETTERS

On Georgia, Citigroup, British Columbia, antitrust policy, health care, Russia, executive pay, China

Jun 18th 2009
From The Economist print edition

Georgia's opposition

SIR – I would like to set the record straight about certain facts in your article on politics in Georgia ("The opposition locks itself up, and out", May 30th). First of all, not every opinion poll gives Mikheil Saakashvili a satisfactory approval-rating. Others show that the president has alienated the majority of his countrymen. Second, the Georgian opposition did not "storm a police station". Instead, the opposition leadership redirected supporters to blockade the railway briefly, not only to avoid the clash Mr Saakashvili was hoping for but also to underscore our commitment to work for peaceful change.

And third, I am not the product of "the Soviet-era *nomenklatura*". Even Mr Saakashvili's supporters avoid calling me that, aware that those who know me and my career would find such an assertion totally absurd.

Many Georgians are fighting against the present danger of Georgia disappearing from the map of the democratic world because of the actions of a man who cloaks his authoritarian approach with democratic verbiage. Our president's constant invocation of the notion that "the war is not yet over" must not become the occasion for the destruction of democracy, and his anti-Russian rhetoric must not be allowed to obscure the fact that he has done more than anyone else to restore the Russian presence in Georgia. We are especially frustrated that Mr Saakashvili has concealed his authoritarian and irresponsible behaviour under the mantle of Western standards and democracy.

Nino Burjanadze
Chairman
Democratic Movement-United Georgia
Tbilisi

Saving for a rainy day

SIR – There is a certain sense of irony in Travelers Insurance replacing Citigroup on the Dow Jones Industrial Average stockmarket index (The world this week, June 6th). Travelers repurchased the red-umbrella corporate logo from Citi just shortly before the current financial storm broke.

Ben Hill
Cardiff

Crime in British Columbia

SIR – I was disappointed by your article on drug-gangs in Vancouver ("British Columbia or Colombia?", May 30th). The fact is, BC's crime rate is dropping dramatically and is at its lowest point in 30 years because of unprecedented investment in policing. We agree that more needs to be done to curb drug-related violence, which is why BC has a comprehensive anti-gang strategy that involves hiring more police and prosecutors, building more jails and introducing tougher laws in conjunction with the federal government.

We are also targeting the tools of gang crime by banning armoured vehicles and body armour and seizing gangsters' houses and cars. A number of high-profile gang members have been arrested. We are making progress while working to maintain some of the safest, most liveable cities in North America.

Gordon Campbell
Premier of British Columbia

Victoria, Canada

_*_ SIR – The title to your article was misleading, as Colombia is not mentioned in the story at all. This only serves to further damage the image of my country and to perpetuate a stereotype. Since 2002, through the implementation of President Álvaro Uribe's democratic security and defence policy, Colombia has made great progress in fighting the illegal-drug trade and restoring security and prosperity. Although there is still much to be done, headlines such as the one you used are neither productive or helpful.

Noemi Sanin Posada
Ambassador for Colombia
London

SIR – I found your headline's reference to Colombia irrelevant and inappropriate when referring to drug crime in British Columbia. Colombia's government has made a concerted effort to combat crime, and successfully so. Its murder rate has shrivelled, and its most violent cities now have homicide rates far less than that of the District of Columbia, where I live. I was relaxing in a grassy park recently only to witness a violent and bloody mugging. It was a Sunday afternoon. Bystanders were paralysed by fear and the incident received little attention in the press. If only the District of Columbia had the political will and resilience of Colombia.

Elizabeth Nicoletti
Washington, DC

Private-party suits

SIR – When listing appropriate reasons for government intervention in the free market, you argued that, "only government can enforce competition rules" ("Piling on", May 30th). On the contrary, the great majority of antitrust cases in the United States are instigated by private parties, not the Justice Department. Surely some part of America's "dynamism" lies in its legal system, which permits, and even encourages, injured parties to sue for antitrust violations.

Perhaps Europe will come to realise that competition law can be enforced efficiently by private parties, without any great need for the heavy hand of government.

John Errico
Gainesville, Florida

Opening shots on health care

SIR – Regarding your article on the future for health-care reform in America, it is providers, not insurers, that are the problem ("The moment of truth", June 6th). The heart of the matter is the perverse fee-for-service system that pays providers not merely for delivering services but for creating services as well. The only way to curtail health-care spending in a meaningful way is to scrap this fee-based system in favour of salaries with modest incentives for improved outcomes.

The health-care system is killing America. It would appear that those who are trying to affect a cure have neither an appropriate diagnosis nor an effective treatment.

Dr Geoff Berg
Warren, Rhode Island

_*_ SIR – Private insurers are not the only ones that are "rapacious". Last October my daughter, who lives in California, gave birth to her first child. She had opted for giving birth at home, but after labour exceeded 48 hours, her husband drove her to the hospital they had chosen as plan B. The baby was born, the procedure requiring not more than some words of encouragement from the staff and a bit of advice regarding positioning and breathing. The little family then had dinner at the hospital, spent the night and went home the next afternoon. Their insurance covered the cost, but they did get to see the bill: $17,000.

Wita Schliewen

Gatineau, Canada

Russia's black market

* SIR – The figure you used for the recent decline in the Russian economy, 9.5% year on year, may be biased ("A new sick man", June 6th). As you mention, the credit crunch has led to barter trade, for which an expertise was developed during the Soviet era. Barter trade has no price in monetary units and thus would hardly enter the national accounts. If it has become the custom once again to exchange products this way it could have a substantial effect on economic data.

Lars-Erik Oller
Stockholm

He who pays the piper

SIR – I was fascinated to see you quote figures from Hewitt and Towers-Perrin as evidence that executive-compensation models function in an effective way ("Attacking the corporate gravy train", May 30th). Fascinated because these are two of the largest consultancies in the world and which, along with competitors such as Mercer, have designed many of the compensation models that the figures defend. This is analogous to using data supplied by KBR (which used to be part of Halliburton) to justify the value of the rebuilding programme in Iraq.

Maury Schott
New York

SIR – You cited a study claiming that 97% of shareholder votes cast in Europe last year endorsed management. You then suggested that this indicates shareholders are happily supportive of executive-compensation packages. If you really believe that those votes meant 97% of shareholders backed management, then I have some mortgage-backed securities I'd like to sell you. The system is broken when management is pulling a share of the vote worthy of Kim Jong Il.

Robert Osten
Boston

China's expurgated version

SIR – I thought your readers would be interested to learn that I bought a copy of *The Economist* at Shanghai airport intending to read the article on the 20th anniversary of Tiananmen listed in the contents ("Silence on the square", May 30th). The article was missing. I went back to the news stall and checked all the other copies only to find the same page had been removed from all of them, and some had been reassembled with the pages in the wrong order.

I complained to a member of staff tongue in cheek that I should not have to pay full price for a publication with pages missing, and was amazed when she agreed and, after talking to her superior, offered a discount of 5%.

Chris Lowsley
Bidborough, Kent

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* Letter appears online only

Economist.com WORLD MIDDLE EAST & AFRICA

Iran's election

Demanding to be counted

Jun 18th 2009 | TEHRAN
From The Economist print edition

An apparently rigged election is shaking the fragile pillars on which the Iranian republic rests

Reuters

IRANIANS voted in record numbers on June 12th. Analysts had predicted a close race; hope of change was in the air. So for many, the official result—with a claimed margin of 63% for the incumbent president, Mahmoud Ahmadinejad—was a preposterous sham. At first, youths took to the streets in Tehran and elsewhere, lighting fires and smashing shop windows. When these were beaten back, opposition grew. Braving an official ban and rumours of police gunfire, well over a million Iranians took to the streets of Tehran on June 15th, dwarfing a televised victory rally staged the day before by Mr Ahmadinejad. A fractured, demoralised opposition suddenly appeared united, empowered and focused on Mir Hosein Mousavi, the soft-spoken former prime minister who, by the official count, had polled only 13m votes to Mr Ahmadinejad's 24m. Their protests have continued ever since.

In the three decades since the Islamic Republic was founded, Iran has not been rocked like this. Tehran is engulfed in huge marches every day. Women in *chadors*, bus conductors, shopkeepers and even turbanned clerics have joined the joyous show of people power. Nationwide strikes are planned.

But the government has struck back. Its men have beaten up protesters and fired on the crowd. Reformers, intellectuals, civil leaders and human-rights activists have been arrested or have gone missing, not only in Tehran but also in Tabriz, in the north-west, and across the country. Since the Ministry of Guidance has expelled foreign journalists, the course of the repression will be hard to follow. And the outcome of this clash is impossible to predict.

The unrest is not, or not yet, about the basic underpinnings of the system created by Iran's 1979 revolution. Protesters have deliberately dressed modestly, enlisting religious symbolism to appeal to the notions of injustice and redemption that lie at the heart of Shia Islam. It is about feelings, shared on both sides of the divide, that the Islamic Republic has gone astray. The split reflects not only a polarised electorate, but also a deep and growing schism within the ruling establishment.

Iran's unique system rests uncomfortably on two pillars, one democratic, the other theocratic. The elected parliament and presidency have plenty of power over state spending and investment, but little over national security, including Iran's controversial nuclear programme. This falls under the aegis of the theocratic branch, embodied by the supreme leader, Ayatollah Ali Khamenei. Mr Khamenei serves not only

as a moral authority but also as commander-in-chief of the armed forces, and controls a range of powerful bodies intended to enforce the “Islamic” nature of the system, including courts, state broadcasting and the Guardian Council, an appointed committee charged, among other things, with vetting candidates and monitoring elections.

Today’s upheaval undermines both these pillars at once. Most Iranians believe electoral fraud has occurred on a massive scale. The implications are far-reaching. Extracting the state from the cloud of suspicion that has fallen over it will be tricky. A clampdown by the army and police, with Mr Ahmadinejad brazening out his critics, would wreck the Islamic Republic’s democratic pretensions for good. But this turmoil has not just undermined Iranian democracy; it has also damaged the prestige of the supreme leader.

Most of Iran’s fast-expanding but hard-pressed urban middle class dislike Mr Ahmadinejad. They suspect that his re-election was intended to stamp legitimacy on the grip of hardliners who consider the “Islamic” bit of the revolution more essential than its “republican” part. Among his opponents are pious conservatives, including some prominent senior clerics, as well as liberals who would, if given a real choice, probably opt for a secular state. But even in south Tehran, a working-class area assumed to be for Mr Ahmadinejad, pro-Mousavi voters thronged the streets: a middle-aged woman in tears lest the election was stolen, and a young man who used the only English word at his command to explain his choice: “Freedom”.

Their leaders are figures who, like Mr Mousavi, gained prominence in the early years of the revolution, but have learned pragmatism since. Many are linked to the reformist movement that briefly thrived during the presidency, from 1997 to 2005, of Muhammad Khatami, a smiling cleric whose enormous popularity failed to make headway against entrenched and occasionally vicious conservative opposition. Several of those arrested this week were Mr Khatami’s close advisers.

Men like these see Mr Ahmadinejad’s administration as dangerously incompetent in its domestic policy and recklessly confrontational in foreign affairs. Most ominous to some have been his purges not just of reformists, but also of the wider revolution-era *nomenklatura* from ministries, local government and universities in favour of people seen as narrow-minded, bullying provincials. This, together with the parcelling-out of rich government contracts to ideological allies such as the Revolutionary Guard, has raised fears that the state is drifting towards a Venezuelan model of demagogic cronyism.

What conservatives dread

The president’s supporters also suspect a coup, but one along the lines of eastern Europe’s colour revolutions. The danger, as they see it, is that Iran’s pure Islamic identity will be diluted by a wave of Western materialism, encouraged by a corrupt elite whose revolutionary ardour has faded. Supporters of Mr Ahmadinejad’s millenarian populism include commanders of the Revolutionary Guard and its larger volunteer auxiliary, the baseej, as well as allies the president has packed into the regular army, police and intelligence services. They are backed by extreme conservatives among the Shia clergy, some of whom say a pious elect, not the people, should rule. Other support comes from the (shrinking) peasantry, pensioners, war veterans and others who have benefited from the spendthrift but scattershot generosity of Mr Ahmadinejad’s government.

Getty Images

Scornful Ahmadinejad

The supreme leader, too, who should theoretically remain above the political fray, has frequently signalled tacit support for Mr Ahmadinejad. This means that he cannot easily dissociate himself, as he has in the past, from whatever electoral malpractice there may have been. Not only did he hastily bless the election result, pre-empting its validation by the Guardian Council as the rules require. He also, before the election, described the kind of candidate voters should choose in terms that made it clear he was referring to the president. Moreover, one of Mr Khamenei’s sons is believed to have not only quietly sponsored the president’s rise from provincial obscurity, but also orchestrated his two presidential campaigns.

The first of these, in 2005, also produced credible charges of fraud, albeit on a smaller scale. Mehdi Karroubi, a reformist cleric who ran in the recent election, was narrowly beaten to second place in a first round of voting because of a suspiciously heavy tilt to Mr Ahmadinejad in outlying provinces. This propelled Mr Ahmadinejad, then a political novice, into a surprise second-round triumph against Hashemi Rafsanjani, a former president. Mr Karroubi’s protests at the time

were quashed by the supreme leader.

This new result looks even more suspect. Before the vote, the president's rivals had voiced worries about possible fraud. A news report claimed that whistleblowers inside the Ministry of Interior, which organises vote-counting, had warned that it planned to tamper with the outcome. Mr Rafsanjani, still a power-broker as head of two bodies that are meant to adjudicate between branches of government, took the unusual step of firing off a long, heated public letter to Mr Khamenei, declaring that unless the supreme leader acted to ensure a fair vote, trouble would ensue.

Conservatives at the heart of Iran's "deep state"—that coterie of officials and clerics who are assumed really to be running things—were known to have been disturbed by the sudden snowballing of support for Mr Mousavi. He had at first been seen as a conveniently weak replacement for Mr Khatami, who withdrew from the race in his favour. Particularly upsetting to them was the disregard for public decorum displayed by the young women ("whores of the West" in one baseej newspaper) who joined Mr Mousavi's rallies. The rigged count itself appeared to many to be a direct response to these fears.

Early on Mr Mousavi, who, supporters say, was tipped off by allies within the Ministry of Interior, proclaimed himself the likely winner. But soon afterwards rolling official results, announced with unusual speed, showed him far behind with only a third of the vote. Suspicions rose further as observers were barred from some counting centres, and the campaign headquarters of Mr Ahmadinejad's opponents found its telephone lines cut, along with the nationwide text-messaging services they had intended to use to keep an independent tally of the vote. Any remaining doubts vanished on June 14th, as police sealed the headquarters of Messrs Karroubi and Mousavi, placed them under house arrest and detained dozens of their most prominent supporters.

Mr Ahmadinejad certainly has millions of enthusiasts, particularly in areas beyond the scrutiny of Tehran's chattering classes. Yet the official result still seemed incredible. Mr Karroubi, for instance, had won more than 5m votes in 2005, but now trailed in last place with a mere 330,000 out of the 39m cast, fewer than the number of spoiled or blank ballots. All three challengers were shown to have lost even in their own home regions, despite strong local loyalties and the expectation of state largesse from having sons in high places.

What could explain such an apparently blatant attempt to rig an election that, even had Mr Mousavi won, would have represented little threat to either the republic or its supreme leader? The most likely theory is of a plan gone awry. Given the line-up of institutions either controlled by Mr Khamenei or systematically packed with Mr Ahmadinejad's supporters, and given that no incumbent president in Iran has yet lost to a challenger, it may have seemed safe to bet on the president's victory. This would have brought the added satisfaction to many dyed-in-the-wool conservatives, possibly including Mr Khamenei, of weakening the position of Mr Rafsanjani, who has mounted a rearguard struggle to contain the president's influence.

Reuters

Cautious Khamenei

Just to make sure, strong potential challengers, such as Mr Khatami and the popular, conservative mayor of Tehran, Muhammad Qalibaf, were "persuaded" by the supreme leader not to run. Compared with the ebullient, politically canny Mr Ahmadinejad, the three remaining challengers appeared drab and uninspiring. Mr Ahmadinejad felt so confident that he agreed to an unprecedented series of televised debates. His superior political skills gave him the advantage on screen, but his scorn for his rivals helped stir up a surge of sympathy for Mr Mousavi, dispelling the political apathy that normally pervades Iran's middle class.

Conservatives suddenly found themselves facing a torrent of youthful activists, their passion for change magnified by the spontaneous but effective use of simple symbols and modern communications. Stunned by this turn of events, Iran's deep state appears to have opted for a last-minute, and therefore clumsy, attempt to alter the outcome in the president's favour.

Democracy in the balance

What will happen now? None of the possible outcomes looks good. Mr Mousavi, who, along with Mr Karroubi, has shown unexpected steel in the face of pressure, insists that the only solution is to cancel the

election results altogether. “Otherwise,” he says, “nothing will remain of people’s trust in the government and ruling system.” Yet, in deference to the Supreme Leader, the three disappointed challengers have also gone through the motions of a formal protest to the Guardian Council.

This 12-man body, chaired by an ultra-conservative who personally endorsed Mr Ahmadinejad, officially has ten days to investigate the charges pressed by Messrs Mousavi and Karroubi. Faced with the pressure of street protests, it has already, grudgingly, agreed to at least a partial recount of votes. Mr Khamenei has sought to bolster his position by issuing his own call for an inquiry. Yet many reformists fear that the intention is to play for time while passions burn out, and then declare some slight irregularities that do not affect the outcome. As a result, they appear grimly determined to carry on the protests.

Reuters

Waiting for change

The more immediate concern is that Mr Ahmadinejad may impose a form of martial law. There are already ominous signs of such a move, as arrests of prominent reformists widen, censorship and controls on communication tighten, and feared vigilantes of the baseej lash out with impunity. Given the machinery of oppression at his disposal, Mr Ahmadinejad could probably maintain power by force, though no one can say for sure where the army stands. But force would devastate the image of a state that he exalts as the pinnacle of good governance. Moreover, Mr Ahmadinejad would need the support of the far more cautious, consensus-seeking supreme leader, and this is far from assured.

Mr Khamenei faces a deep quandary. A resolution to the crisis that fails to assuage the huge and growing mass of Mr Mousavi’s supporters would do permanent damage to his regime’s democratic pillar. Few Iranians would ever again deign to volunteer for the empty pageantry of voting. Yet giving in completely to their demands would expose his own weakness and fallibility. Underlying all this is the bitter irony that in its paranoia to avoid a “velvet revolution”, Iran’s deep state has itself engineered precisely the conditions that might make such a revolution happen.

Coverage of the protests

Twitter 1, CNN 0

Jun 18th 2009 | LOS ANGELES
From The Economist print edition

But the real winner was an unusual hybrid of old and new media

ON SATURDAY June 13th, as protests began to flare on streets across Iran, 10.5m American TV-viewers naturally turned to CNN, a cable news channel founded in 1980. It was a vote of confidence in the traditional news media. Unfortunately, instead of protests many of them saw CNN's veteran, Larry King, interviewing burly motorcycle-builders. The programme was a repeat.

No other American television news programme, cable or broadcast, did better (though the BBC and Al-Jazeera were both swifter and more plugged-in). But that was little comfort. Thanks to the internet, dedicated news-watchers knew what they were missing. Twitter and YouTube carried a stream of reports, pictures and film from Iran's streets. The internet also facilitated media criticism. Twitter hosted an extraordinary outburst of fury against CNN and other news organisations. A typical post: "Iran went to hell. Media went to bed."

For a while it looked like a clear-cut victory of new media over old. Cable news channels, which had supplied wall-to-wall coverage of the disappearance of John F. Kennedy junior on another Saturday ten years ago, had neglected a big story. Yet old media recovered. Responding to what Tony Maddox, head of CNN International, delicately calls "real-time audience response", the network ramped up its coverage of Iran. By June 16th Americans were getting decent reports, and even Mr King was paying attention to the story. In a back-handed compliment, the Iranian authorities cracked down harder on journalists.

Meanwhile the much-ballyhooed Twitter swiftly degraded into pointlessness. By deluging threads like Iranelection with cries of support for the protesters, Americans and Britons rendered the site almost useless as a source of information—something that Iran's government had tried and failed to do. Even at its best the site gave a partial, one-sided view of events. Both Twitter and YouTube are hobbled as sources of news by their clumsy search engines.

Much more impressive were the desk-bound bloggers. Nico Pitney of the *Huffington Post*, Andrew Sullivan of the *Atlantic* and Robert Mackey of the *New York Times* waded into a morass of information and pulled out the most useful bits. Their websites turned into a mish-mash of tweets, psephological studies, videos and links to newspaper and television reports. It was not pretty, and some of it turned out to be inaccurate. But it was by far the most comprehensive coverage available in English. The winner of the Iranian protests was neither old media nor new media, but a hybrid of the two.

Economist.com WORLD UNITED STATES

Obama, Iran and North Korea

Meeting thuggery with coolness

Jun 18th 2009 | WASHINGTON, DC
From The Economist print edition

The president is playing a cautious game with rogue regimes

AFP

AS IRAN is rocked by the largest street protests since the revolution of 1979, Barack Obama is pursuing a policy of “wait and see”. His priority is to prevent the Iranian regime from acquiring a nuclear bomb. His preferred method is to negotiate directly with Iran’s leaders. Since it is not clear who will end up in charge in Tehran, he is biding his time.

On June 12th, Iran held a presidential election. Before there was time to count the votes, the Iranian government announced that the incumbent, Mahmoud Ahmadinejad, had won by an astonishing margin. At this point, many Americans would have liked their president to have spoken out. Most take a dim view of Mr Ahmadinejad, who denies that the Holocaust happened but makes veiled threats to unleash another one on Israel. Many Americans believe that he or his allies rigged the poll, and that Mr Obama should say so in clear and searing language. Senator John McCain, Mr Obama’s former rival, called the Iranian election an obvious sham and called for action of some kind.

But Mr Obama is playing it cool. He waited until June 15th to offer a few scrupulously measured words. He said he was “deeply troubled” by the violence he had seen on television. He noted that the Iranian government had said it would investigate “irregularities” with the vote. He cautioned that since there were no international observers on the ground, he could “not state definitively” what had happened. He stressed that “it is up to Iranians to make decisions about who Iran’s leaders will be”. This cautious policy, though, could easily be upended if events in Iran were to turn bloodier still.

He pointedly refrained from offering even verbal support to Mir Hosein Mousavi, the reformist leader whose supporters are thronging the streets crying foul—though he did go so far as to say that “we do believe that the Iranian people and their voices should be heard and respected.” Even his vice-president, Joe Biden, who on the campaign trail called Mr Ahmadinejad a “madman”, “that wacko guy” and “the crazy president”, kept his mouth uncharacteristically shut. Pressed by a television interviewer, he said only that he had “doubts” about the Iranian election.

Mr Obama’s critics accused him of failing to support democrats and oppose theocrats with sufficient vigour.

“The administration’s silence in the face of Iran’s brutal suppression of democratic rights represents a step backwards for home-grown democracy in the [Middle East],” growled Eric Cantor, the House Republican whip. “It’s very clear that the president’s policies of going around the world and apologising for America aren’t working,” said Mitt Romney, a once and perhaps future Republican presidential candidate.

Mr Obama seems unruffled. Given the history of American-Iranian relations, (which include a CIA-sponsored coup in 1953), it would not be productive to be seen to be meddling in an Iranian election, he said. He would rather let Iranians decide who will rule them. The decision may not be made democratically, but there is little America can do about this, he calculates.

He could offer full-throated or even material support to the opposition, but this would probably backfire: the regime would then be able to portray its opponents as stooges of the Great Satan. So Mr Obama will wait and then deal with whoever emerges on top, predicts Brian Katulis, an analyst at the Centre for American Progress, a think-tank with close links to the White House.

Meanwhile, assuming the current Iranian regime remains in power, Mr Obama will enter negotiations with low expectations, says Mr Katulis. Iran’s leaders seem determined to acquire a nuclear capability that would enable them to make a bomb in short order and to find the means to deliver it. Gentle persuasion is unlikely to sway them. But if Mr Obama is seen to give diplomacy a chance, he may find it easier to build international support for sanctions. Currently, the Treasury makes life hard for banks that do business with Iran, but other countries, particularly Russia, resist the imposition of anything tougher.

Mr Obama is gambling that he can reshape global opinion. A first step is to persuade Muslims that America is not their enemy. In a speech in Cairo this month he quoted the Koran, praised Islamic culture and promised a “new beginning” based on “mutual interest and mutual respect”. In a speech to mark the Iranian new year back in March, he praised Iran’s “great civilisation”, saying he wants it “to take its rightful place in the community of nations”.

If he makes it harder to caricature Americans as bloodthirsty imperialists, he figures, he will deny hardliners in Iran and elsewhere one of their most potent rhetorical tools. And that could make it slightly less difficult for him to resolve the Middle Eastern problems that have frustrated every previous American president, he hopes. He sees many of the region’s ills as interconnected; but he has not yet hit on a grand strategy for addressing them.

Instead, he is feeling his way, trying to keep as many people on his side as possible. When Israel’s prime minister, Binyamin Netanyahu, announced on June 14th that he could accept a Palestinian state but only under conditions most Palestinians deplore (see article), Mr Obama tactfully stressed the positive. “What we’re seeing is at least the possibility that we can restart serious talks,” he ventured.

Meanwhile, he has upset pro-Israeli hawks by demanding an end to the expansion of Jewish settlements on Palestinian land. He is also pressing Israel not to try to destroy Iran’s nuclear programme by bombing it. But as much as people like to suggest that Israel is an American puppet, it is not, says Michael Rubin, an Iran expert at the American Enterprise Institute, a conservative think-tank.

Also troubling Mr Obama this week was the other surviving member of George Bush’s axis of evil. Last week, the UN Security Council tightened sanctions on North Korea for its illegal nuclear weapons. On June 16th, the *New York Times* reported that the American navy will try to search North Korean ships suspected of smuggling arms or nuclear technology. The paper said American sailors would not board North Korean ships without permission. But they would follow them into ports and insist that the countries where they dock refuse to let them refuel unless they submit to inspections.

At a joint press conference with the president of South Korea Mr Obama confirmed the main thrust of the report, but stressed that the details are still being discussed with China, Russia, Japan and South Korea. “There’s been a pattern in the past where North Korea behaves in a belligerent fashion, and if it waits long enough [it] is then rewarded,” said Mr Obama. “We are going to break that pattern.”

Transport spending

Delays ahead

Jun 18th 2009 | CHICAGO
From The Economist print edition

Ambitious plans for American transport run into reality

THE biggest shift in transport policy since the 1950s is due, supposedly, this summer. February's stimulus package provided about $48 billion for transport, a pittance in comparison. As *The Economist* went to press on June 18th James Oberstar, the chairman of the House Transportation and Infrastructure Committee, was about to present a blueprint for a new transport bill. The old act expires on September 30th; the new one would span six years and authorise $500 billion in spending. More important, the money would be spent differently. The way Americans move and live might change too.

AP

Let the train take the strain

The trouble with a bold, $500 billion plan is that it requires $500 billion. The Highway Trust Fund provides federal money for transport. It will be broke by late August. On June 17th Ray LaHood, the transport secretary, said that he wants to postpone the bill's reauthorisation.

Few would defend America's current transport policy. Each year congestion costs more than $78 billion in wasted hours and petrol. Washington's main transport strategy has been not to have one. The Department of Transportation (DoT) runs 108 different programmes. But an integrated system for planning—one that includes passenger rail, freight, highways and mass transport—does not exist. Full analyses of projects' costs or benefits are rare. Too much federal funding for transport is just a blank cheque to the states, reckons Robert Puentes of the Brookings Institution, a think-tank. Though America's 100 biggest metropolitan areas account for 75% of the country's economic output, transport money is seldom focused on them. The stimulus plan, with its need to create jobs quickly, did little to alter this.

Concerns over volatile petrol prices, congestion, climate change, ageing infrastructure and wasted money have prompted calls for change. Now a strategy is emerging at last. Mr Oberstar would spend $450 billion on roads, bridges and mass transport, 38% above current levels, and devote $50 billion to high-speed rail. The federal government would set clear objectives, such as reducing carbon emissions from transport, and track states' progress towards meeting them. The 108 spending programmes would be rationalised. New schemes would ease congestion in metropolitan areas and freight networks. The review process for new projects would be streamlined to reduce delays. A national infrastructure bank would seek to leverage additional investment.

Such ambitious plans, however, may have to be postponed. Mr LaHood wants to extend the old transport bill by 18 months. Even without a new bill, there may be room for progress, says a hopeful James Corless of Transportation for America, a reform group. The transport secretary says he would send more money to metropolitan areas and use cost-benefit analyses to guide investment. The DoT is already encouraging plans to build housing near transport, expand access to buses, subways and bicycles, and reduce emissions in the process.

Still, a main question remains unanswered. The Highway Trust Fund will soon be empty. There is no

consensus on how to fill it. The gas (petrol) tax, the main source of revenue for transport, has remained flat since 1993. Revenues have declined as travel has ebbed in the recession and cars have become more efficient. In the long term, congestion pricing is the best solution, but it could take years to adopt. In the meantime the Obama administration is loth to raise the gas tax. Siphoning money from general funds is an easy but unsustainable answer. There may be a new vision for transport, but it will never progress until someone is willing to pay for it.

The health-care debate

Will the blue dogs bolt?

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From The Economist print edition

Reform advances in fits and starts

"HEALTH-CARE reform should be guided by a simple principle: fix what's broken and build on what works." With those soothing words, Barack Obama tried this week to win over a faction that has more power than any other to scupper his ambitious health reforms: doctors. This took some courage, for the American Medical Association (AMA), the profession's leading lobbying group, has traditionally been suspicious of grand schemes for reform. Addressing the group's convention in Chicago on June 15th, Mr Obama promised to consider reforms to the country's tort system that lead to "defensive medicine". Noting that no other Democratic president had touched this topic, the AMA's leaders heaped praise on Mr Obama after his talk.

That was a step forward for his reform efforts, but this week also brought a setback from the Congressional Budget Office (CBO). Mr Obama and congressional leaders have vowed that any health plan they develop together this year must be budget-neutral, so the views of the CBO's bean counters matter a lot. The current plans to watch are the ones developed by Edward Kennedy, who chairs the Senate's Health Committee, and by Max Baucus, who heads its Finance Committee. The former plan is already public, while the latter was due to be released later this week.

Alas, the agency has thrown a monkey-wrench into the works. Its assessment of the Kennedy plan argues that this supposedly "universal" scheme would cost a trillion dollars over 10 years but cover only about one-third of the country's uninsured. On the heels of that shock, reports surfaced suggesting that the CBO's assessment of the Baucus plan put its price tag at $1.5 trillion. That reportedly delayed the release of the Baucus plan this week.

Conservatives have seized upon the CBO reports as evidence that all the Democratic talk of fiscal responsibility and budget neutrality is mere guff to disguise an enormous expansion of government. Some on the left retort that it does not matter much what Republicans think, as procedural devices make it possible for Mr Obama to push any final health plan through the Senate with only 50 votes rather than the usual 60. True; but fiscally conservative Democrats (known as blue dogs) are also likely to find a profligate health bill unacceptable, possibly depriving Mr Obama of the 50 he would need.

So bipartisanship still matters, but is it possible? Tom Daschle thinks so. The former senator, who was meant to head up Mr Obama's health efforts before he got into trouble over his taxes, remains an influential voice. On June 17th, the Bipartisan Policy Centre (an outfit led by Mr Daschle and several other former Senate majority leaders of both parties) released its own health-reform blueprint.

The worthies endorse several of the big ideas now gaining ground among reformers. They advocate far tighter regulation of the health-insurance market, along with policies that push individuals to purchase insurance. They endorse greater transparency, for example through better use of health-information technologies. And offer a variety of sensible suggestions for paying for all of this—including the modification of the tax exclusion that currently favours employer-provided insurance.

Their most striking suggestion, however, involves the controversial notion of a health-insurance plan run by the federal government. Liberals demand one, but the insurance industry and conservatives are dead set against the notion. Mr Daschle's group has come up with an elegant compromise. Private insurers will be given five years to establish universal coverage. If they fail, the president would be obliged to submit a public plan proposal to Congress for speedy consideration.

Economist.com

WORLD

UNITED STATES

Keeping poultry in cities

Checking out the chicks

Jun 18th 2009 | AUSTIN

From The Economist print edition

The financial and health reasons behind a new craze

Aurora

Green pets

ONE day Judith Haller was watching television and saw that Martha Stewart had chickens. “I was very envious that she had her own chicken manure,” she recalls. So last year, she got a couple of chickens on behalf of her vegetable garden. They proved to be industrious providers and pleasant companions. Now there are 13 hens pecking around the yard. And Ms Haller has become an advocate for a hot movement: backyard chickens. In April, as part of Austin’s first Funky Chicken Coop Tour, she hosted 637 visitors.

Chickens are having a moment. For Americans who are concerned about eating locally or organically, hens can help. They produce fresh, free-range eggs. They eat table scraps, and their waste goes in the compost pile. Finances are a factor for some families. Mimi Bernhardt says that she and her partner became more reflective about sustainability when the economy worsened. Now they are growing melons, tomatoes, onions and aubergines, and they raise ducks as well as chickens. Their grocery bill has plummeted. There is also a pet aspect. Hens are soft and fluffy, if not very affectionate. As Ms Haller puts it, they make cats seem like dogs.

It is impossible to know exactly how many Americans have joined this trend. The Department of Agriculture does not track hobbyists. Owners can register via the National Animal Identification System, but it is strictly voluntary. This is a sore point with some health experts, who say that America needs a better way to keep track of its animals.

In any case, signs point to a bird surge. Hatcheries that deliver chicks by mail have reported backlogs. Rob Ludlow, the owner of BackyardChickens.com, says that his forum has 35,000 members and about 100 more joining each day. Backyard poultry groups meet in at least two dozen cities, from Seattle in Washington to Tallahassee in Florida. Over the past few years many cities have, in response to public pressure, relaxed ordinances against the birds.

Andy Schneider, a radio host known as the Chicken Whisperer, says he gets calls every day from people who are interested in challenging their city council on this score. Web sites like Craigslist, Facebook and Twitter help them organise. “If you have 50 people wearing buttons saying ‘I love chickens’ on the steps of the courthouse, it does make a statement,” he says.

Mayoral control of schools in New York

Political prisoners

Jun 18th 2009 | NEW YORK
From The Economist print edition

Albany's dysfunction jeopardises important legislation

AP

Is Joel Klein (right) fading?

MICHAEL HARPER, a dad from Brooklyn, spent his day off earlier this month at a City Hall hearing on mayoral control of New York's schools. Wearing a T-shirt that said "Control de Alcaldía = Mejores Escuelas" on the back and "Mayoral Control = Better Schools" on the front, Mr Harper hopes control of the city's schools remains firmly in the hands of the mayor. The school governance law granting the mayor sweeping powers is about to expire. In 2002, Michael Bloomberg (pictured left) convinced Albany's lawmakers to give him full control of the city's schools, which were in dire straits. Back then, indeed, he described the school system as being "in a state of emergency". There was no cohesion and there was no one person in charge. The 1.1m children in the system suffered: graduation rates were abysmal and test scores were terrible.

Under Mr Bloomberg's stewardship, the changes have been vast. Not only have teachers seen a 43% increase in salaries, school funding has increased by nearly 50%. Principals have been given more autonomy and more accountability. And most importantly, the children are doing a lot better. In 2002, only half of the city's fourth-graders met state learning standards. Today, 85% are meeting or exceeding maths standards and 70% are meeting or exceeding English standards. Graduation rates have also started to increase.

Most New Yorkers agree that mayoral control should continue, even Randi Weingarten, president of the American Federation of Teachers, the second biggest teacher's union in the country. Ms Weingarten, no fan of Joel Klein, Mr Bloomberg's schools' chancellor, wants the state legislature to reauthorise the law, but with modifications. She would like the mayor to retain budget control and to drive policy, but wants a system with more checks and balances. Joseph Viteritti, editor of "When Mayors Take Charge", a book on school reform, agrees that modifications are needed. He would like parents to have more of a voice. He points out that "it is very hard to separate mayoral control from Bloomberg control" and that New Yorkers must think beyond Mr Bloomberg.

Unfortunately lawmakers in Albany, the state capital, are not thinking about New York's children or any of their constituents at the moment. Ever since two Democratic state senators formed a coalition with the Republicans on June 8th, the place has been in chaos. The switch gave the Republicans a temporary majority, until Hiram Monserrate, one of the dissident Democrats, switched back again a week later to rejoin the Democratic caucus. This has left the state's Senate tied at 31-31. Under usual circumstances, the lieutenant governor could be relied on to break any deadlock, but the position has been vacant since David Paterson replaced Eliot Spitzer as governor following a prostitution scandal.

Time is running out, and the Senate has yet to vote on extending mayoral control, which expires on June 30th—though Albany's session supposedly concludes for the summer eight days earlier, on June 22nd. As *The Economist* went to press, the Senate leadership is in chaos, the chamber is deadlocked and all legislation is in limbo. That's bad news for Mr Harper.

Church attendance in recessions

No rush for pews

Jun 18th 2009
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A counter-intuitive finding from the pollsters

ON THE campaign trail, Barack Obama famously claimed that blue-collar workers in Pennsylvania clung to religion because of bitterness over lost jobs. Americans are now truly fearful, as unemployment has mounted and house prices fallen. Yet the theory that church attendance grows in times of economic crisis seems to be a myth.

Last year David Beckworth, an assistant professor of Economics at Texas State University, examined historic patterns in the size of evangelical congregations and found that, during each recession cycle between 1968 and 2004, membership of evangelical churches jumped by 50%. This report filled the newspapers and TV news-shows at the height of the depression panic just before Christmas; but the report's findings focused on evangelicals, and do not apply to Americans at large.

According to Frank Newport, the editor-in-chief of Gallup Poll, which interviews 30,000 Americans every month, "to guess that attendance would increase [in recessions] is a common-sense assumption with no basis in data." John Green, a senior fellow at the Pew Forum on Religion and Public Life, which recently published a study on the correlation between church attendance and economics, has found no link in the past 20 years.

Interestingly, says Gallup, the percentage of Americans who tick the "no religious preference" box has steadily grown, from 0-3% 40 years ago to 12-15% now, while church attendance has remained steady.

Mr Green says that real spikes in attendance have occurred only in times of national disaster, such as September 11th 2001, or the Cuban missile crisis. Mr Newport goes even further, noting that, after September 11th, there was only a short-term blip in attendance. Evidently, this recession is "not providing a society-wide worry about the future."

Mr Green explains that economic problems are uneven in their effects: "Perhaps the unemployed are going to church more, but others may be going less." The financial crisis, then, may not seem as terrible to God-fearing Americans as the hype has suggested. As Mr Green concludes, "We've had recessions before, and we always come out of them." Or could it be that Mr Obama's victory has produced a sense that help is on the way?

The mayor of Los Angeles

Down and perhaps in

Jun 18th 2009 | LOS ANGELES
From The Economist print edition

Will Antonio Villaraigosa run for governor of California?

AP

Villaraigosa is not finished yet

TO JUDGE from magazine covers, things look bad for Antonio Villaraigosa, the mayor of Los Angeles, who is still deciding whether to run for governor of California next year. On *Newsweek*'s cover in 2005, after he became mayor in a landslide victory, the title was “A Latin Power Surge”. The cover of *Los Angeles* magazine this month said simply “Failure”.

Only a few months ago Mr Villaraigosa was a strong contender for 2010, even against such a formidable figure as fellow Democrat Jerry Brown, who is a former governor, the son of a former governor, and currently the state’s attorney-general. Mr Villaraigosa’s base among Latinos and his rags-to-power personal history gave him a good chance.

But then all of California—through no fault of Mr Villaraigosa’s—entered a financial and political crisis, pulling the finances of Los Angeles down with it. Mr Villaraigosa secured re-election by an embarrassingly slender margin against obscure challengers last March. Having wrecked his marriage by having an affair with one attractive television newscaster two years ago, he is now seen enjoying the company of another, a former Miss USA.

However, among Californian Democrats, that last matter need not be a disaster. Another Democratic candidate for governor, Gavin Newsom, the well-groomed mayor of San Francisco, had an affair with the wife of his then campaign manager with no apparent electoral consequences.

Nor is Mr Villaraigosa quite the disaster the local press alleges; the cards have been stacked against him. A mayor of Los Angeles has far less power than, say, his counterpart in smaller San Francisco, which is both a city and a county. But unlike the current governor, Mr Villaraigosa has at least shown he is able to get (small) tax increases approved by voters; he won a battle to increase the Los Angeles sales tax to pay for transport improvements last year. The mayor’s main ambition has been to improve the city’s schools, fighting in the legislature and courts to pry control over education away from the autonomous school board that runs them, and winning a small victory.

In a way these experiences might actually help him, were he to win. A governor of California, like a Los Angeles mayor, has highly circumscribed powers, and has to rely on cunning and compromise. The governor does not appoint his most senior officials (office-holders are elected individually) and, besides that, he needs two-thirds majorities in both houses of the legislature to pass a budget or raise a tax. Voters decide many big issues directly through the ballot box. Hence California’s current impasse, which may well see the state run out of cash next month.

Other candidates have their weaknesses too. Mr Brown, if he wins, has long experience and a mighty intellect to rely on, but many voters will feel he is simply too old for the job: he will be 72 by the time of the election. Gavin Newsom, a hero to the left for his stance on gay marriage, is an ideological pariah to the right. Republican candidates such as Meg Whitman, a former boss of eBay, and Steve Poizner, another Silicon Valley tycoon who is now insurance commissioner, lack sufficient experience of politics. And Mr Brown and Mr Newsom, who both hail from the north of California, could well split each other’s vote in the Democratic primary.

Mr Villaraigosa is not as Latino as he seems. He grew up as Tony Villar, speaking English with his single

mother, and learned Spanish only as an adult. Intellectually he is no match for Mr Brown, nor ideologically for Mr Newsom. But he is a Machiavellian politician, ready to make or cross allies. When he was speaker of California's assembly, he recalls, "I mixed up the physical seating order" to make Democrats and Republicans work together, and they did. It is too soon to count him out.

Cracking down on smoking

Marlboro Country no more

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From The Economist print edition

A new era for tobacco regulation is born

A DECADE ago it would have been unthinkable, but on June 12th, Congress passed the toughest anti-tobacco bill in American history. Those who had waged a long fight against "Big Tobacco" rejoiced. Senator Edward Kennedy hailed the bill as proof that "miracles still happen" in Washington, DC.

The Family Smoking Prevention and Tobacco Control Act gives the Food and Drug Administration (FDA) broad power to regulate tobacco products and marketing efforts. Health advocates have long complained that the FDA has oversight over more innocuous products, like lipstick, but not cigarettes, which are responsible for more than 400,000 American deaths a year. The new law will require disclosure of all product ingredients and the placement of more prominent warning labels on packages. The FDA will also have the right to review all new tobacco products before they go to market and to ban companies from advertising any of its products as healthier alternatives by describing them as "lite" or "mild", for example.

The bill focuses on deterring young people from puffing away. It will outlaw flavoured tobacco (except for menthol), which some claim lures children, and bar tobacco advertisements from appearing near schools. The Congressional Budget Office says the new legislation will reduce the number of young smokers by 11% and adult smokers by 2% by 2019. Some say the legislation will save many more lives. Nine out of ten smokers start before the age of 18, reckons the American Cancer Society's advocacy affiliate, so hindering tobacco companies' access to youth could reduce the number of smokers dramatically in the long term.

The new law adds more pain to the tobacco industry, which saw a federal tax on cigarettes nearly triple earlier this year and the imposition of many new state-level bans on smoking in public places. Now the tobacco industry must finance the government's new regulatory activities by paying fees according to each company's share of the market. The total cost of the FDA's tobacco regulations will begin at $85 million a year and rise to over $700 million in ten years. The battle is not over, though. The tobacco companies are expected to go to court, contesting the advertising restrictions as an infringement of the constitutional right to free speech.

Lexington

Madame Secretary

Jun 18th 2009
From The Economist print edition

Barack Obama's fiercest opponent has become one of his most solid allies

Illustration by KAL

ONE of Barack Obama's riskiest decisions, on winning the presidential election, was to choose Hillary Clinton as his secretary of state. The Obama-Clinton duel was among the most vicious in Democratic Party history, and some of the sharpest clashes were over foreign policy.

The Obama camp accused Mrs Clinton of Bush-like support for invading Iraq and shaking up rogue states (at one point she even threatened to "obliterate" Iran if it attacked Israel). The Clinton camp retorted that Mr Obama was a soft-hearted neophyte who was too eager to talk to dangerous strongmen, such as Mahmoud Ahmadinejad. These ideological tensions were reinforced by personal animosities. Richard Holbrooke has had a running feud with Anthony Lake, one of Mr Obama's closest foreign-policy advisers. Samantha Power, another Obama adviser, described Mrs Clinton as a "monster" and was fired for it.

Mischief-makers have been trying to discover tensions between the two former rivals ever since Mrs Clinton moved to Foggy Bottom in January. So far they have been frustrated, despite the fact that the issues that once divided them have been at the heart of foreign policy, and many of the same egos are still at work (Ms Power is now ensconced in the National Security Council and Mr Holbrooke is "special representative" for Afghanistan and Pakistan.)

Mr Obama and Mrs Clinton have hewed to the same line over the current uproar in Iran—expressing worries about the violence but avoiding raising the spectre of "American interference". Mrs Clinton has followed Mr Obama's lead in holding out a welcoming hand to assorted anti-American strongmen. "President Obama won the election. He beat me in a primary in which he put forth a different approach," was her sharp response to a Republican congressman who reminded her of her former hawkishness when Mr Obama shook Hugo Chávez's hand. Mrs Clinton now enjoys the highest popularity rating of any of Mr Obama's cabinet; she also enjoys the admiration of some Republicans, such as Mark Kirk, a member of the congressional subcommittee that overseas the State Department, who calls her "the superstar of the cabinet".

Mrs Clinton's success has partly been a matter of good fortune. The State Department is delighted to see

the arrival of an administration that does not regard Foggy Bottom as enemy-occupied territory. It also has better relations with the Pentagon than it has had for years. If Donald Rumsfeld went out of his way to antagonise State, Robert Gates, who replaced him in 2006, has bent over backwards to woo it, publicly agonising over the “creeping militarisation” of foreign policy and calling for a “dramatic increase” in the “civilian instruments” of national security, such as diplomacy and foreign aid.

But Mrs Clinton has also made the best of her opportunities. She has struck a balance between deploying her star power and deferring to the president. She is routinely greeted as a rock star wherever she goes, and has enjoyed mixing with ordinary people: holding a spirited discussion with the teenage audience of an Indonesian television show, “Awesome”, for example. But she has always known when to defer to Mr Obama or other cabinet secretaries, such as Tim Geithner.

Mrs Clinton has also brought a tough-minded professionalism to her job. She has inevitably encountered resistance, given the number of fingers in the foreign-policy pie—including those of a vice-president, Joe Biden, with a long-standing interest in foreign affairs. The State Department bureaucracy is critical of her habit of surrounding herself with loyalists such as Cheryl Mills, a former White House lawyer who was one of her most important aides during the final days of her presidential campaign. Human-rights activists are also furious about her reluctance to lecture foreign governments, particularly China, on that subject.

But she has won more battles than she has lost—notably with Mr Biden, over whether America should send 21,000 troops to Afghanistan. And America’s foreign-policy machinery is now working as well as it has in years. One of her shrewdest moves was to divide the job of deputy secretary into two, with James Steinberg focusing on policy and Jack Lew on management. Mr Steinberg is respected on both sides of the former Clinton-Obama divide. Mr Lew, a former White House budget director, helped Mrs Clinton win a 10% budget increase for the department.

A workhorse not a showhorse

Mrs Clinton has also seemed content to delegate the day-to-day management of some of the world’s most volatile regions to special envoys: the Afghanistan-Pakistan region to Mr Holbrooke; the Middle East peace process to George Mitchell; and the Gulf and south-west Asia to Dennis Ross. (That last appointment, though, has gone awry: Mr Ross is apparently being moved to the White House.) But in general Mrs Clinton has disentangled herself enough from the daily demands of these regions to focus on strategic questions that are too often given short shrift: overhauling the management of foreign aid, improving the United States’ relations with Latin America and managing the rise of Asia, which is arguably the most important strategic issue facing the country. Mrs Clinton’s new-found collegial style and managerial competence is a godsend for the Obama administration at a momentous time for American foreign policy—and a principal reason why the country has been spared from one of the “difficult transitions” that Mr Steinberg once wrote a book about. The only disappointment, from her point of view, is that she did not bring the same skills to fighting Mr Obama, a year ago, that she is now bringing to serving him. If she had, Mr Obama might have been the one learning how to play second fiddle.

Economist.com/blogs/lexington

Argentina's mid-term election

The glass empties for the Kirchners

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From The Economist print edition

Recession and political mistakes by the first couple point to a change in the balance of power. But will Argentina at last acquire a more coherent opposition?

Reuters

UNTIL about three months ago, as the southern-hemisphere summer drew to a close, Argentines had expected an autumn of relative calm. Then President Cristina Fernández de Kirchner, who governs with her husband and predecessor, Néstor Kirchner (pictured above), suddenly decided to bring forward to June 28th a mid-term legislative election that was not due until October. The switch prompted a flurry of fund-raising from across the political spectrum. "This time there's a chance of a return on any investment," says Nicolás Ducoté, a political analyst. After six years in which the Kirchners have had Argentine politics in their grip, change is in the now-wintry air.

Polls suggest that the first couple will lose their majority in the lower house of Congress, where half the seats are up for election. Mr Kirchner, who is standing in Buenos Aires province is neck-and-neck with Francisco de Narváez, a businessman who heads a dissident group within the ruling Peronist movement. Mr Kirchner will be elected, but a failure to beat Mr de Narváez to the top of the poll in the province, home to 40% of the electorate and of the rustbelt suburbs that have been his main base, would be a humiliation.

During Mr Kirchner's presidential term, from 2003 to 2007, things went well. Spurred by high world prices for Argentina's farm exports, the economy swiftly recovered from its collapse of 2001-02. Mr Kirchner's brutal debt restructuring helped at first (but the later failure to tie up the loose ends has not). The opposition was fragmented: Mr Kirchner blamed the collapse on the policies of Carlos Menem, the president in the 1990s and leader of the Peronist right, and the Radicals were discredited by having failed to prevent it when in power. In 2007 Ms Fernández was easily elected with 45% of the vote.

Hopes that she would be more moderate than her abrasive husband were quickly dashed. Having tried to raise taxes on agricultural exports to extortionate levels, she turned the resulting dispute with angry farmers into a trial of strength which she lost. She seems to share her husband's antipathy to private business, nationalising an airline and criticising Techint, a big steel-products group. Meanwhile, the global recession hit Argentina's economy.

The Kirchners' decision to turn the election into a plebiscite on their economic policies looks ham-fisted,

since two-thirds of respondents now disapprove of these, according to Poliarquía, a pollster. Although export prices are improving and there are signs that the recession may be relatively short, unemployment could be Mr Kirchner's undoing. In some suburbs of Buenos Aires it has climbed to 17%; in such places over 40% of people are now poor, the highest figure since 2002. Crime, another worry, has risen under the Kirchners, although it is still low compared with many other South American countries.

All this has made Ms Fernández unpopular and galvanised the private sector, the Peronist right and the opposition in a campaign that has largely been free of policy debate and packed with dirty tricks. Mr de Narváez has drawn on his own fortune in his battle to beat Mr Kirchner, plastering Buenos Aires province with bus-sized posters of himself.

Mr Kirchner, who heads the Peronist movement, has resorted to artifice. He has tarted up his list of candidates with some 40 mayors and the province's governor, even though few are likely to take up congressional seats. He has used the presidential helicopter for many campaign trips. Many Argentines see his hand in an attempt by a much-questioned judge to link Mr de Narváez to a suspected smuggler (although there is no direct evidence of that).

Nowadays the Kirchners have few friends in the media. They are mercilessly pilloried on "Gran Cuñada", a satirical campaign version of "Big Brother". Mr de Narváez owns a newspaper and a television channel. But he has also quietly built a political base, organising grass-roots discussion groups in the aftermath of the 2001-02 economic crisis.

Since he was born in Colombia, Mr de Narváez is barred from ever running for president. But thanks partly to his efforts, power looks likely to swing back towards the Peronist right. The Radical party still suffers from splits and a shortage of cash, although its leaders hope this month's vote will mark the start of their recuperation. A poor result for the Kirchners would mean that the presidential poll in two years' time would be wide open. And depending on Ms Fernández's reaction, it could usher in either more business-friendly economic policies, or two years of rising confrontation.

Venezuela's oil-dependent economy

Socialism on the never-never

Jun 18th 2009 | CARACAS
From The Economist print edition

Hard times on the streets of Caracas

Panos

Grab the chicken while stocks last

GLOBAL capitalism may be in crisis, but thanks to "21st-century socialism" Venezuela's economy is "armour-plated" and the country's poor have nothing to fear. That has been the message from Hugo Chávez, Venezuela's president, and his ministers in recent months. If anyone is to suffer from the lower price of oil, the country's mainstay, they insist it will be only "the oligarchy". And serve them right: according to Mr Chávez, the rich are merely "animals in human form".

The oil price has doubled from its December trough (although it is still only half its peak of a year ago), so one might expect Mr Chávez's fighting talk to be reflected in resilient living standards. But inflation is close to 30%, real wages are falling and welfare schemes have suffered big cuts in their budget. The mood on the streets of poorer suburbs of Caracas, the capital, is glum.

"I go shopping whenever I can scrape together enough money," says Pedro López, a bricklayer who has been out of work for the past three months. Officially, unemployment is stable at around 7%. But Mr López says: "It's not just me. Lots of my workmates have been laid off too." According to the Central Bank, the economy grew by 0.3% in the first quarter compared with the same months of 2008. Construction is supposed to have expanded by 3.6%. But some economists doubt the figures.

Public investment is under strain. This month, for example, the boss of Caracas's metro system announced a review of a new line already under construction, with the probable scrapping of two stations. He argued that since these were in middle-class areas they would "benefit the oligarchy" who all have cars anyway. Other public-sector projects have slowed or stalled, seemingly for lack of funds.

Consumer confidence fell by 17% between December and May, according to Datanálisis, a market-research company. Food consumption among poorer Venezuelans may be declining, says Pavel Gómez, an economist at IESA, a Caracas business school. Opinion polls reveal a sharp rise in worries over the cost of living. The government's answer to years of persistent inflation has been price controls and Mercal, a state-owned and subsidised grocery chain that offers a limited selection of staples at discounts of up to 40%. But Mercal's sales fell by more than 11% in the first five months of this year, partly because of store closures and distribution problems.

"Every day, things get a little tighter," said Migdalia Pérez, a community activist in Catia, a working-class district of 500,000 people in western Caracas. "And it's been a while since we've had a Mercal around here." Near Propatria metro station, a dozen Mercal employees sit idle by the door of the local branch. They insist it is being "refurbished". Locals say it opens only when an occasional shipment of imported chicken arrives. Smaller corner shops known as Mercalitos which devote some shelf-space to subsidised goods are also closing down. "It's not profitable," says José Cabrita, who owned one. "They don't allow you any margin." He adds that supplies were erratic.

The most popular of Mr Chávez's social *misiones* is Barrio Adentro, which includes a network of primary-health centres initially staffed by thousands of Cuban doctors. But many of these have also closed. Poorer Venezuelans must rely on rundown public hospitals, which have been starved of funds under Mr Chávez. Mr López, the bricklayer, says that when he broke his wrist in an industrial accident, "it took three months to fix it, and I had to buy the metal pins myself."

Much of the money for the dozens of social *misiones* which Mr Chávez set up as a parallel welfare state

came direct from PDVSA, the state oil company. But its oil output has been falling. When the oil price plunged last year, its direct transfers to welfare programmes fell to $2.7 billion, from $7.1 billion in 2007. That is because responsibility for the *misiones* has been handed over to the relevant ministries, according to Rafael Ramírez, PDVSA's chairman. But since oil revenues pay for around half of the government's budget, this has not prevented cuts in welfare spending.

On the face of things, the recent recovery in the price of oil to around $70 a barrel should enable Mr Chávez to muddle through without radical shifts in policy. But Venezuela's generally heavy and sulphurous oil sells at a discount of around $10 a barrel. To sustain public spending at its peak level without deficits would have required Venezuelan oil to sell at an average of $90 a barrel last year, according to a calculation by Domingo Maza Zavala, a former governor of the Central Bank. The magic price would be higher still today, given inflation (the official exchange rate is pegged to the dollar) and the further expansion of the state through the nationalisation of private businesses.

So that points to a mixture of cuts and borrowing. Since public debt was low, at 20% of GDP last year, and Venezuelan banks have ever-fewer private clients, there is some room for further loans. The National Assembly duly authorised fresh government borrowing this month. But Mr Chávez's hopes of remaining in power for decades to come depend, as ever, on the price of oil.

Mexico's drug war

All in the family

Jun 18th 2009 | MEXICO CITY
From The Economist print edition

Suspicion falls on politicians

FELIPE CALDERÓN has bet his presidency on fighting Mexico’s drug-trafficking syndicates and their penetration of his country’s institutions. Yet for the first two and a half years of his administration, not a single elected official was arrested for complicity with the traffickers. That encouraged some of his Mexican critics to claim that his efforts were half-hearted. Now the government has started to answer them.

Last month troops and federal police swooped on the president’s home state of Michoacán, arresting 28 officials including ten mayors, a senior official in the prosecutor’s office and a judge. They are suspected of collaborating with *La Familia*, a notorious outfit that produces designer drugs and runs extortion rackets. Further arrests have followed across the country this month. Although they have not caused as much of a political stir, they involved eight employees of the prosecutor’s office in the central state of Morelos, nine soldiers suspected of providing information on troop movements to the Sinaloa mob and 98 police in Nuevo León in the north.

The government claims the Michoacán raid as the fruit of reforms of the federal police, who have been equipped with new investigative and intelligence units, better salaries and more leeway to strike deals with informants. Much of the evidence came from the earlier arrest of Rafael Cedeño Hernández, a leader of *La Familia* who also ran youth centres with the ostensible aim of preventing drug addiction.

But critics worry that the raid is just a fishing expedition and that the government may lack the evidence it needs to secure convictions. None of the detainees has been charged. Prosecutors are relying on orders of *arraigo*, a power beefed-up in a judicial reform last year that allows them to hold suspects for up to 90 days while detectives do their work. “Instead of investigating to arrest, they’re arresting to investigate,” says Ernesto López Portillo of the Institute for Security and Democracy, an NGO. “*Arraigo* is an exceptional instrument, and they are abusing it.”

Although two of the arrested mayors are members of Mr Calderón’s own conservative National Action Party, the raid has soured his relations with the opposition. Michoacán’s governor, Leonel Godoy, who belongs to the leftish Party of the Democratic Revolution, is not suspected of corruption, but was not told of the arrests until they were under way. Mr Godoy took particular offence when federal agents barged into his palace. This jeopardises co-operation between federal and state officials, though the government would argue that it has to prevent tip-offs.

Some opponents accuse Mr Calderón of pulling a stunt ahead of a mid-term election on July 5th. To deflect such claims, the government will need to secure convictions, and continue its campaign against narco-politics after the election.

Canada's troubled nuclear industry

Ending a dream, or nightmare

Jun 18th 2009 | OTTAWA
From The Economist print edition

The government opts not to pour more money down the nuclear “sinkhole”

AP

But not for much longer

NO ONE should have been surprised when Canada’s elderly nuclear research-reactor near Ottawa sprang a leak last month, prompting a prolonged shutdown that removes two-fifths of the world’s supply of a medical isotope widely used in the diagnosis and treatment of cancer. After all, the government-owned reactor was fired up in 1957, the same year that the Soviet Union launched *Sputnik* and Elvis Presley starred in “Jailhouse Rock”. But the reactor’s second unscheduled shutdown in as many years left health officials in Canada and the United States scrambling to find alternative sources of the isotope. Hospitals in both countries rescheduled thousands of tests and treatments.

This debacle has stirred Stephen Harper’s Conservative minority government into a decision. It says it will divide AECL, the state-owned atomic-energy company, into two, privatising all or part of its division that makes and services nuclear-power stations while winding down the research reactor. Eventually, says Mr Harper, Canada will get out of making isotopes altogether. His spokesman used blunter language, saying that AECL was “dysfunctional” and a “sinkhole” that has cost the Canadian governments C$30bn ($26.5 billion) since its creation in 1952.

Critics worry that the government is getting out of the nuclear business just when concerns about fossil fuels are prompting its renaissance. They believe that demand will rise not just for medical isotopes but also for Canada’s CANDU reactors, which use a different technology from many elsewhere. Canada led the world in the development of radioactive isotopes for medical diagnosis and therapy, says Jacalyn Duffin, a medical historian at Queen’s University in Ontario. “Why quit now?” But supporters of privatisation such as the C.D. Howe Institute, a think-tank, say that AECL is too small to survive, and the sale of its potentially profitable parts is the only way a nuclear resurgence in Canada is possible.

Canada’s dream of being a nuclear power began in 1943 when Mackenzie King, the prime minister, agreed with Winston Churchill and Franklin Roosevelt to co-operate on nuclear research. But government backing for peaceful nuclear operations later withered, a casualty of deficit-reduction under the past two Liberal governments and the Conservatives’ preference for smaller government. With a stimulus package driving the federal budget’s forecast deficit up to C$50bn this fiscal year, Mr Harper does not want to add to the C$1.7 billion his government has given AECL since coming to power in 2006.

Health officials in the United States are seeking an American supplier of medical isotopes, having decided that Canada is no longer a reliable source of molybdenum-99, which when processed into technetium-99m is used in two-thirds of all diagnostic medical-isotope procedures south of the border. As long as AECL was working on two replacement reactors, American processing firms were content to wait. But Canada cancelled the replacement programme last year when the new reactors, already eight years behind schedule and hundreds of millions of dollars over budget, failed tests.

In Canada the isotope shortage has become a liability for Mr Harper. Lisa Raitt, the minister responsible for AECL, apologised to cancer patients after she was caught on tape discussing how her career might benefit if she solved the “sexy” isotope crisis. Leona Aglukkaq, the health minister whom Ms Raitt also criticised in the taped conversation, says she has arranged for new supplies from Australia. Yet Australia has problems of its own with its single, albeit newish reactor, and has recently been importing isotopes from South Africa. Capitalising on government disarray, Michael Ignatieff, the Liberal leader, demanded more information on isotope supply as one of several small concessions he extracted from Mr Harper in return for keeping the government in office by agreeing to back it in a confidence motion on the budget due for debate in the House of Commons on June 19th.

AECL's nuclear-power business has also suffered in recent years. Its CANDU reactors were once thought superior because they could be refuelled without shutting down. But rival technologies have improved. Potential foreign buyers of the company are waiting to see whether AECL's latest, previously untried design wins a competition this summer to build a new reactor for Ontario's provincial government. Should the province select either of two rivals—a French consortium headed by Areva or an American consortium headed by Westinghouse, both of which use different reactor technology—the new CANDU design will probably be aborted. AECL's business would be limited to servicing the 48 nuclear-power plants around the world that use its technology. And Canada's nuclear dream would have died.

Politics in Thailand

Fading colours

Jun 18th 2009 | BANGKOK
From The Economist print edition

The prime minister tries to spend his way out of trouble

Illustration by David Simonds

IN THE end, Thailand's ruling coalition sailed through what had been billed as a serious parliamentary test of strength. A request for an extra 800 billion baht ($23 billion) to stimulate an economy that shrank by 7.1% year-on-year in the first quarter was passed by comfortable majorities in two televised late-night sittings this week. Opposition members seized on the opportunity to grumble about mounting public debt. But the Democrat Party, led by the prime minister, Abhisit Vejjajiva, who took office last December, emerged from the debate largely unruffled. That has buoyed hopes that his administration, which faced down violent protests in April, can outlast its short-lived predecessors.

Crucial to its survival will be its ability to pump money into a feeble economy while keeping uppity coalition parties in check. In the past Democrat-led governments have stumbled over corruption scandals. Oxford-educated Mr Abhisit is keen to avoid a repeat. But to form a government he has been forced to hobnob with characters whose records are not for the squeamish. They include veteran dealmakers, such as Newin Chidchob, a banned MP who nonetheless runs an influential group in the seven-party coalition. Mr Newin has cajoled the government to approve the leasing of 4,000 gas-fuelled public buses for Bangkok's clogged streets. The ten-year, 68 billion baht scheme recently hit a speed bump, though, as critics picked over its inflated cost structure. Alarmed by the outcry, Mr Abhisit delayed the deal by referring it to a planning-agency review.

Doubtless Mr Abhisit's coalition partners will find ways to feather their nests before the next general election. The government's eagerness to boost spending to counter the recession is ideal for populist vote-getting. Some observers believe an election could follow in January or February 2010. After April's thwarted uprising by red-shirted protesters loyal to Thaksin Shinawatra, a fugitive former prime minister, Mr Abhisit resisted calls for an election. Now Democrats appear more ready to go to the polls. Some even fancy their chances of improving on their showing in December 2007. Then, they polled second to the pro-Thaksin People's Power Party (PPP), whose court-ordered dissolution in December ushered in the Democrats.

But an improved Democrat showing seems a tall order. Even before April's violent spasms, Mr Abhisit was pelted by red-shirted opponents during his forays into rural areas. These are now no-go zones for the Democrats, says Chris Baker, a political analyst in Bangkok. Mr Abhisit travels in a bulletproof Mercedes that

rarely leaves the capital. This in turn increases the leverage of Mr Newin and other coalition partners with networks in Thailand's populous north-east, Mr Thaksin's power-base.

Their popularity will be put to the test on June 21st in two by-elections that pit Mr Newin's Bhum Jai Thai Party against Peua Thai, the pro-Thaksin successor to the PPP. A victory for Bhum Jai Thai is likely to trigger more defections in parliament from the rudderless Peua Thai. Similarly, the broader anti-government red-shirt movement is floundering after a crackdown by security forces. But the seething public anger on display in April is still potent and can easily upset the best laid plans of Bangkok.

Another wild card is the People's Alliance for Democracy (PAD), the conservative protest group that helped topple Mr Thaksin and his proxies in 2006 and 2008—the yellow shirts in Thailand's colour-coded political landscape. They have registered a new political party, paving the way for it to contest at the next election. It might take votes from the Democrats, with whom its support base overlaps. Good, say PAD activists, who have soured on Mr Abhisit, accusing him of coddling former Thaksin henchmen such as Mr Newin. But they concede that the party is a risky step for a movement that drew on middle-class disgust with grubby politics-as-normal.

Complicating this combustible mix is an upsurge in violence in Thailand's Muslim-dominated far south, where a mosque shooting on June 8th has triggered a bloody round of sectarian, tit-for-tat killings. Local Muslims accused security forces of the shooting; the army claimed that militants did it to discredit the authorities. Since January 2004 over 3,500 people have died in the area. Successive Thai governments have vowed to end an insurgency that appears bent on making the area ungovernable, possibly as a prelude to a breakaway state. Few believe Mr Abhisit will make much headway. That does not mean, however, that he should not try. Peace in the south is a more worthwhile goal than finding money for the north-east to build roads to nowhere.

Kazakhstan's purge

The knock on the door

Jun 18th 2009 | ALMATY
From The Economist print edition

First they came for the bankers

Agency Anzenberger

Nazarbayev: always a big-picture politician

FAMILY ties can make or break a person in Kazakhstan. They help when it comes to advancing a career, be it in business or in politics. Kazakh tradition requires you to support your relatives whenever possible. If your family lacks clout, an alternative is to attach yourself to a well-placed patron. One drawback with this system, however, is that it works both ways: if the patron falls for whatever reason, it almost always leads to the downfall of everyone connected with him.

This helps explain the shocking, unprecedented numbers of Kazakhstani officials and businessmen in trouble in recent months. *Ekspert Kazakhstan*, a business weekly, this month carried a picture of a faceless man in a dark suit and tie, covered with horizontal white stripes and the headline “Everyone is being put in clink!” Some older people talk of troubling echoes of Stalin’s purges in the late 1930s.

That is ludicrous. Nobody has died. But a seemingly arbitrary wave of arrests—mostly on charges of corruption and embezzlement—and the obvious lack of legal protection against it have fostered a climate of fear. The timing seems bizarre. Kazakhstan is about to achieve a long-coveted badge of international respectability, by taking over in 2010 the one-year chairmanship of the Organisation for Security and Co-operation in Europe (OSCE). It won this honour thanks to the government’s pledge to improve legislation in areas such as the freedom of the press and political parties.

Now, because of the extra attention it will bring, the OSCE role may actually backfire. Kazakhstan could find its international image even murkier. But domestic politics now trump any diplomatic concerns. Yevgenii Zhovtis, a well-known human-rights activist, detects signs of “a brutal internal war among the elites”, to clear the way for a successor to the long-serving authoritarian president, Nursultan Nazarbayev, whose term ends in 2012. Mr Zhovtis says it is anybody’s guess to what extent Mr Nazarbayev himself is involved. The political turmoil was triggered in part by the impact of the global economic crisis on Kazakhstan, an oil-rich country that was booming until 2007, and the weakened state of both private and state companies. In February this year BTA Bank, then Kazakhstan’s largest bank, was nationalised, ostensibly to prevent its collapse, and its chairman, Mukhtar Ablyazov, a one-time opposition leader, stripped of his position. He left the country for exile in London from where he has been railing against the nationalisation, while avoiding a criminal investigation into alleged racketeering and money-laundering.

Since other members of his management team also left hastily, the authorities are vigorously pursuing other leads, spreading fear among the remaining BTA employees. A letter to an opposition newspaper described a BTA employee so frightened by a summons from the authorities that she went into hiding. The letter claimed that the authorities then detained her mother instead and held her for three days. Overall, more than a

dozen BTA managers have been arrested and are expected to go on trial some time this summer. A number of senior officials have also been arrested on charges of corruption, including the deputy ministers of environment and defence and the deputy head of the statistics agency. A few other bank and company managers fearing the same fate have chosen to disappear.

The biggest shock, however, was the arrest in late May of Mukhtar Dzhakishev, the much-respected head of the state nuclear agency, Kazatomprom, and friend of Mr Ablyazov. Mr Dzhakishev was accused of stealing Kazakhstan’s uranium deposits, which, given the strict oversight of the industry, seems unlikely. His deputies are being held as potential witnesses and are said to have been mistreated. In all, eight of his associates have been arrested.

Despite official claims that all these cases are unrelated criminal investigations, most observers see a political motive, even if it is unclear who is to benefit. The crackdown has dented foreign investors’ confidence in the country and is causing many to wonder who is next.

Nepal's fragile new government

False start

Jun 18th 2009 | KATHMANDU
From The Economist print edition

In office but not yet in power

THE ashes of the Maoist government in Nepal have been scattered, but the moderate Communist one that replaced it last month has done little to assure observers that it is the new holder of the country’s seats of power. As rival coalition parties continue to bicker over ministerial portfolios, the country is beginning to tire of waiting for a new cabinet, and worries about instability mount.

Madhav Kumar Nepal, the country’s post-Maoist prime minister, is trying to mediate as best he can, but to little avail. The main coalition partners, including his ruling Unified Marxist-Leninist (UML) party, the Nepali Congress and the Madhesi Janadhikar Forum, this week at last agreed on how to carve up cabinet posts; other, smaller parties are still in talks. Only after the cabinet forms can the Constituent Assembly elected last year hope to get on with its tasks of constitution-making and peace-building.

The Maoists, meanwhile, no longer in government, are making it clear they are not quite out of power. On June 15th activists from their Youth Communist League were able to shut down the capital, Kathmandu, after they accused the UML’s youth faction of murdering one of their leaders. Flag-waving, tyre-burning groups enforced the shutting of shops and held up cyclists; other traffic dared not venture out.

The scene recalled the bad old days of political instability and paralysis in the capital during the ten-year civil war with the Maoists that ended in 2006. The only noises to puncture the padding of pedestrians around the city were the screeching of sirens from ambulances and police cars, and the cheers of animated activists.

This strike was one of many protests across the country over the bigger issue of the aborted sacking in May of the chief of the army by the Maoist prime minister, Pushpa Kamal Dahal (formerly known as Prachanda). This led the Maoists to quit government. But they remain determined that most of around 23,000 former Maoist guerrillas, still in UN-supervised cantonments, will be merged with the national army. The army remains opposed to this, and is backed by the other big parties and by India, an overbearing neighbour.

In the name of civilian supremacy, the Maoists are now blockading the assembly. They have even threatened to set up parallel governments in some districts. A series of attacks—by other groups as well as the Maoists—has raised concerns about worsening political violence. Despite the Maoists’ repeated assertions of commitment to peace, there is a lingering fear that they may return to the jungle.

Nepal has had 18 governments since 1990. So it is not far-fetched to imagine the collapse of this latest one after just a few weeks. Nor is a return to civil war out of the question. When it comes to forming a government, the cards are still in Mr Nepal’s hands. That achieved, it may be possible to coax the Maoists back to the table. But lasting peace still hinges on the future of the two armies and that dispute shows few signs of being settled.

Australia and anti-Indian violence

Regrettable facts

Jun 18th 2009 | SYDNEY
From The Economist print edition

Thuggery mars a burgeoning friendship

AFP

Making a stand in Mumbai

BELYING its name, Harris Park is neither leafy nor green. It is a gritty western Sydney suburb, where Indian students have recently taken to the streets in protest against some of the worst ethnic-based attacks Australia has seen. As young Indian men gather by the local railway station, police converge further down the street and arrest two non-Indians. Asked about the wave of violence against their community, two Indians lower their voices. “Lebanese,” says one. Others wonder if the answer may be more complicated.

The violence sprang to public notice when two Indian men were attacked with screwdrivers in Melbourne last month. One was robbed. Both ended up in hospital. A demonstration of about 2,000 Indian students in Melbourne called for stronger police action. They claimed the attacks fitted into a wider pattern of violence over the past year against Indians in Australia. The Melbourne attacks came as a firebomb was hurled in Harris Park through the window of a house where young Indians lived. One suffered bad burns. On June 8th two more Indians were attacked near a Harris Park restaurant, where Indian community leaders had gathered, prompting two successive nights of demonstrations in the suburb. The Indian press accused Australia of racism. Amitabh Bachchan, a Bollywood superstar, refused an honorary doctorate from a university in Brisbane.

Over the past 40 years Australia has received waves of immigrants from Vietnam, Lebanon and other parts of Asia and the Middle East. Most have settled peaceably. Indians are the latest to arrive. In the decade to 2006 the number of Australian residents born in India almost doubled. India was the third-fastest-growing source of immigrants, after New Zealand and China.

There has also been a big increase in students coming from India, especially in courses for skills where qualifications offer a fast track to permanent residency. Since 2006 Indian enrolments in such “vocational” courses jumped by 161%, reaching 52,000 last year. Many Indian students have fanned out from inner-city student quarters to private colleges in the suburbs, and to places like Harris Park where rents are cheaper, and crime rates higher. In recent years Indians have displaced Lebanese as the suburb’s biggest ethnic group.

Initially, police said the motive for the glut of attacks on Indians was robbery: students going home from night jobs carrying money and mobile phones were “soft” targets. Later, they conceded that some attacks were race-based. Many Indian students privately blame Lebanese youths, who may well be jobless gang-members. But at Billu’s Indian Eatery and Sweet House, a Harris Park gathering point, Aruna Chandrala, an Indian community leader, carefully avoids censure. “It’s a law-and-order issue,” she says. “The students are saying ‘Enough is enough’.”

It has also become a diplomatic embarrassment for Australia, at a time when it has been seeking to boost relations with India to what Stephen Smith, Australia’s foreign minister, calls “the front rank of our international partnerships”. Kumari Selja, India’s tourism minister, has cancelled a planned visit to Australia in July. And Manmohan Singh, the prime minister, has said he is “appalled” at the violence, calling some of it racially motivated.

Kevin Rudd, his Australian counterpart, dismissed race as a motive, and called the violence “just a regrettable fact of urban life”. About 20 Australians, he pointed out, had been assaulted or murdered in India over the past decade. That is a good debating point: but not one that will help persuade Indian parents that

Australia is a safe place to send their children.

China's schistosomiasis scourge

Hello again, God of Plague

Jun 18th 2009 | POYANG LAKE, JIANGXI PROVINCE
From The Economist print edition

Slow progress against snail-fever

PAINT flakes off the signs that dot the shore of Poyang lake, rendering the faded red characters unreadable. But local villagers know the message all too well: “Danger! Don’t touch the water.” For fishermen and farmers whose fortunes are bound to China’s largest freshwater source, disobedience is the only option. The price is daily exposure to the water-borne, parasitic worm *Schistosoma japonicum* which is carried by the millions of tiny fingernail snails that infest the marshland. It tunnels through human skin, invades the bloodstream and lays eggs. Victims of schistosomiasis, also called snail-fever, suffer chronic diarrhoea, fatigue and fever. In severe cases, infection can lead to swollen stomachs, bladder cancer, liver damage and death.

It is the world’s second-most prevalent tropical disease after malaria, affecting 207m people of whom 726,000 are Chinese, according to the most recent official figures, from 2004. People around Poyang, one of the areas where the disease is endemic, laud Chairman Mao for ensuring the number is no higher. He ordered a fierce, if rudimentary, campaign in the late 1950s when cases neared 12m. Scores of peasants were told to sharpen their chopsticks and spear as many snails as they could find. The campaign reduced cases by several million in a decade and Mao penned a poem: “Farewell, God of Plague”.

As in so much else, the Chairman was overhasty. Subsequent efforts to eradicate the disease failed, despite the arrival in the 1980s of Praziquantel, a drug scientists say is highly effective in controlling the disease but fails to prevent reinfection. A note of optimism, though, sounded earlier this year. Chinese researchers announced they had reduced infection rates in two villages near Poyang to less than 1% by replacing water buffaloes, a parasite host, with tractors, and improving sanitation.

In Xinhe, one of the villages, educational posters adorn houses. The God of Longevity is plastered on the living-room wall of Hu Zhanping, the local Communist Party secretary. Next to this is a photograph of his father, who died of snail-fever 30 years ago. Mr Hu has the worm but the free medicine keeps it at bay. Next door, Mr Fu is a village anomaly: he has lived past 80. In his youth, he recalls, it was not pregnant women who had the biggest bellies, it was the men. Then they would waste away.

Mr Hu hopes Xinhe will be an example to the world. Experts say China can take a lead in tackling the disease in Asia and Africa but not before it cleans up its own backyard. Nine-tenths of the world’s schistosomiasis sufferers live in Africa and studies have shown the disease leaves sufferers more susceptible to HIV infection.

A protracted struggle beckons on the shores of Poyang and China’s other big lakes. East of Xinhe is the town of Li Hong, home to a ramshackle clinic billed as a Snail-Fever Control Centre. It still receives up to 30 patients a day. A fisherman lies groaning on a grubby bed, clutching his distended belly with one hand, clasping his wife’s hand with the other. He spends two months a year here. The medical bills devour his income, so he only seeks treatment when the pain becomes unbearable.

Residents of a 600-strong settlement outside Li Hong speak of the latest death. The diagnosis came too late; but hardly as a surprise, since 90% of the hamlet’s population is infected. Ignorance about the disease and how to treat it remains shockingly high. Some refuse to take Praziquantel, believing it will hamper their ability to work. Students and migrant workers often miss their chance of treatment. Villagers also rail against the government policy of using molluscides to kill the snails. They pay workers not to scatter the powder in the water as it depletes shrimp stocks and endangers eel farms.

Deeper flaws are emerging. Substituting tractors for buffaloes could prove too costly. The economic slowdown has driven migrant workers home, increasing populations in affected areas. But the chief concern is the impact of that emblem of controversy, the Three Gorges Dam. Scientists fear changes in water levels along the Yangzi could create new snail habitats in areas previously untouched by the disease. Ohio State University is tracking the changing shape of Poyang by satellite as it tries to predict high-risk areas. But experts agree the long-term solution is to find a vaccine. Whenever that comes, for thousands of China’s lakeside villagers, it will be too late.

Gay rights in China

Comrades-in-arms

Jun 18th 2009 | SHANGHAI
From The Economist print edition

The long march out of the closet

ImagineChina

Sing if you're happy that way

AS A boy of 15 in north-eastern China, Dylan Chen knew he was gay. "I grew up thinking I was the only gay person in all of China," says Mr Chen, now 25 and living in Shanghai. Small wonder. Homosexuality had been decriminalised in China only two years before. It would be officially classified for several years more as a mental illness. Information and acceptance were both in very short supply.

Life for China's tens of millions of homosexuals has improved markedly since then, especially in big cities. Gay and lesbian bars, clubs, support groups and websites abound. Chinese gays, who playfully call themselves "comrades", have plenty of scope for networking. One surprising website caters specifically for gays in China's army and police force.

But even in cosmopolitan Shanghai tolerance has its limits, as Mr Chen and others learned this month when they planned a series of plays, film screenings, panel discussions and parties called Shanghai Pride Week. The organisers, a group of local and expatriate gays, ran into last-minute trouble as city officials forced the cancellation or relocation of some events. Hannah Miller, an American who has lived in Shanghai for five years and was one of the main organisers, knew better than even to think of staging something as brazen as a parade. She hoped that limiting events to private venues and promotional materials to English would be enough to deter unwanted official attention.

In the end eight events went ahead, attended by some 4,000 people, and Ms Miller judged it all a big success. The Chinese press has begun cautiously to report the events, which Mr Chen sees as a big step forward, and a welcome departure from the usual stories about AIDS or the alienation of Chinese homosexuals.

But attitudes will not change easily, especially away from large cities. Traditional values emphasise conventional family life and the continuation of blood lines. The government, meanwhile, has shown a willingness quietly to tolerate homosexuality, but has failed to do much in the way of providing explicit protection. Tentative legislative proposals to expand gay rights have died swift unnoticed deaths. Always wary of rocking the boat, the government routinely quashes attempts at social-activism and rights promotion. Lawyers and activists advocating gay rights have been harassed, and, though many gay websites are accessible, some are blocked.

Very accessible are places like Eddy's Bar on Shanghai's west side. A rarity when it opened in 1995, it is now one of the city's many gay hotspots. This week, apparently undented by the gay-pride kerfuffle, business was brisk.

Economist.com WORLD ASIA

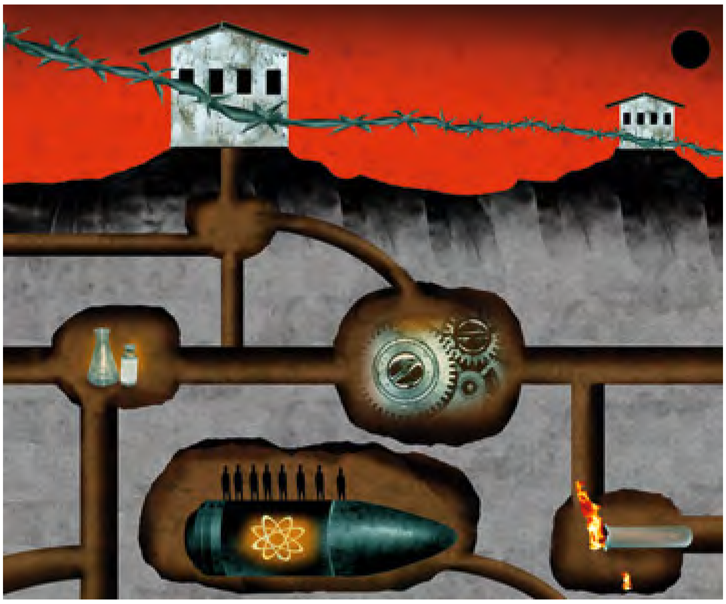
Banyan

Kim family saga: third and final act

Jun 18th 2009
From The Economist print edition

North Korea's dictator is on the way out; take aim at his successor

Illustration by M. Morgenstern



BRUTAL, pot-bellied and unpredictable: the same adjectives are always together on the larder shelf when editorial writers describe Kim Jong Il. But how helpful are they any more? There's no quibbling over Mr Kim's brutality. He runs his country like a gulag, and a Kim-made famine killed a twentieth of the population in the 1990s. As for pot-bellied, the description no longer holds, since, after a presumed stroke last summer, the Dear Leader looks frail, and as gaunt as his underfed subjects.

And unpredictable? The word has always been unhelpful, for it misses how foreseeably Mr Kim's Communist dynasty has blackmailed the outside world, defying the odds and the end of the cold war to cling to power. The notion of unpredictability is based on the tantrums North Korea throws. The latest began earlier this year with bellicose rhetoric, missiles and, last month, a presumed nuclear explosion (though spooks are puzzled at the lack of radiation, and wonder if this was simply a mountain-full of TNT). Yet ever since the North's push for a nuclear capability caused increasing concern in the early 1990s these hissy fits have been routine. Each time North Korea has cranked up the tension only to try to exploit it, usually by returning to multilateral negotiations on better terms—more aid goodies and respect.

With the latest nuclear test, Mr Kim has raised the stakes higher than usual. To many that belongs to the familiar wearisome pattern of abuse. President Barack Obama, who has yet to articulate a North Korean policy, has begun to talk of the country as if it were an ill-behaved toddler that should not be rewarded for bad behaviour. Robert Gates, his defence secretary, says that America is "tired of buying the same horse twice". President Lee Myung-bak of South Korea has reversed his predecessors'"sunshine policy" of unconditional aid. Fool me once, shame on you. Fool me again (and again), shame on me.

Yet now a growing band of North Korea-watchers, even in China, divines a new unpredictability which, they say, is more disturbing than the tired old blackmail. This band says North Korea no longer intends to return to the table. After the United Nations Security Council imposed fresh sanctions on June 12th, as punishment for the nuclear test, the North said it would not just make more plutonium bombs, but enrich uranium too. Unlike earlier bellicosity, today's rhetoric lacks calibration. When North Korea now says it does not mean to give up its bid to be a nuclear-weapons power, blimey, perhaps it means it. This week Mr Lee was in Washington to seek Mr Obama's reassurance that South Korea sits under American protection, and to make it clear that neither country would accept North Korea as a nuclear state.

It was always wishful thinking to suppose that Mr Kim was developing his nukes in order to trade them away. His dynasty has spent half a century trying to acquire them, and the deal on offer from the outside world is unalluring. In essence it offers North Korea development aid and recognition in return for nuclear disarmament. Neither side of this bargain is in Mr Kim's interests. He would lose two powerful, related tools of totalitarian control: the claim to be holding the line against an outside world bent on war and destruction; and the enforced isolation of his benighted people. A nuclear deal would make a nonsense of the first claim, while development would bring much more knowledge about the outside world.

Now his own poor health and the looming succession make even the pretence of a negotiated process too risky. The alternative to the status quo is not gradualist modernisation, as in China. Rather, it is collapse and unification on South Korea's terms. Already, the broad population is profoundly embittered with the corrupt tinpot despotism. If Mr Kim and his cronies are not tried for crimes against humanity, it may be because they have already been strung up from lampposts. In trying to ensure his dynasty's survival, the hard line is the 68-year-old Mr Kim's only option. He is digging his regime in for the long term. Quite literally: the country is a vast network of tunnels and underground complexes for the leaders. Starved of cash, North Korea is drawn to other pariahs for business—even selling tunnelling advice to Myanmar's junta, another bunch of totalitarian troglodytes.

Un-likely to succeed

After him is another matter. This Mr Kim has anointed as successor his 26-year-old third son, Kim Jong Un. The older Kim relied for his legitimacy on the strength of his father, Kim Il Sung. From his father he assumed the mantle of a neo-Confucian sun king, not unlike Emperor Hirohito before the war. The irony is rich since Kim and his fellow band of guerrillas swore oaths of fealty to each other when fighting the Japanese (and Japan remains a bogey). They became North Korea's ruling elite. The oaths passed with Mr Kim to the second generation, which holds all important posts of power. But now his pot belly is gone, his left arm looks nearly paralysed, and intimations of his mortality abound.

Can the third generation hang together? More likely, they will hang separately. These days other temptations distract the elite, which travels widely. Take Mr Kim's eldest son, accosted this month by Japanese television crews in Macau. Yes, he had also read the reports about his younger brother. Yes, the decision was his father's, with unerring judgment. No, he hadn't spoken to his father for a while. And (the subtext): could he please go gambling now? This generation of Kims does not look promising, and that is great news. At his Swiss boarding school, where he passed as the son of a chauffeur, Kim Jong Un was known for bossing players around on the basketball court. It is a start, but hardly adequate training for an absolute dictator. And that is just why the outside world should not give up on North Korea but stick with its inducements. They will yet prove the regime's undoing.

Economist.com/blogs/banyan

Zimbabwe's hard sell

A warm welcome but little money

Jun 18th 2009
From The Economist print edition

So far Morgan Tsvangirai's ground-breaking tour of America and Europe has brought plaudits rather than cash for Zimbabwe's battered economy

Getty Images

IT IS Monday, so it must be Berlin. Or is it Stockholm? Morgan Tsvangirai may be forgiven for occasionally losing track, so crammed has his schedule been on his first official tour abroad as Zimbabwe's prime minister. On June 15th it was the turn of Germany's chancellor, Angela Merkel (pictured above), to meet him in Berlin, after he had spent a few days in Washington, DC, where he met President Barack Obama. Then he headed north to meet the Swedes, before flying across to Norway. He was also due to meet the leaders of Belgium, Denmark and France, plus officials from the European Union. Finally, on June 19th, he is to visit Britain for several days to hobnob with the prime minister, Gordon Brown, plus various other politicians and would-be investors.

Mr Tsvangirai always knew that this first official visit would be tricky. Tendai Biti, his finance minister, had already done the rounds of Western capitals with his begging-bowl and had come back empty-handed. So although the former opposition leader naturally hoped he would drum up a bit of extra cash for his shattered country, it was not the main aim of his trip. Rather it was to gain international support and recognition for himself and his Movement for Democratic Change (MDC) in their uneven power struggle with President Robert Mugabe and his Zanu-PF.

To that extent, the trip has already been a success. Anxious to boost Mr Tsvangirai at the expense of Mr Mugabe, foreign leaders have showered him with praise. Mr Obama talked about his "extraordinary admiration for the courage and the tenacity that the prime minister has shown in navigating through some very difficult political times." Ms Merkel said Mr Tsvangirai was a symbol of democracy and deserved support. He was also sure to get a warm reception in London, where successive British governments have led international opposition to Mr Mugabe's rule. In this respect, Mr Brown is as fiercely anti-Mugabe as his predecessors.

However, it is no surprise that the man who was beaten up, jailed and threatened with death by Mr Mugabe and his security forces is finding it hard to persuade his foreign hosts that the "period of acrimony" between himself and the despotic president is "over" and that Zimbabwe is now "on an irreversible transition to

democracy". Few seem convinced. Some have even accused him of trying to deceive his interlocutors by painting too rosy a picture of the new Zimbabwe, perhaps out of a misplaced sense of patriotism.

Yes, there have been some improvements. The hyperinflation of recent years, for instance, has been brought under control. But Zanu-PF is already warning its people to prepare for a snap election, perhaps as early as next March, in an apparent attempt by Mr Mugabe to block the introduction of a planned new constitution, with clear limits on executive power and strict rules for elections. Four months after the unity government was set up, Mr Mugabe still completely controls the armed forces, the police, the intelligence service, the media and criminal justice. Political opponents and human-rights campaigners are still arrested and thrown into the country's jails on trumped-up charges.

White-owned farms are still being seized and invaded. Gideon Gono, the central-bank governor who oversaw the hyperinflation that helped destroy the country's once-flourishing economy, is still in his job. And the 85-year-old Mr Mugabe continues to call the shots in what is supposed to be a partnership of equals.

So Mr Tsvangirai got little change when it came to winning direct financial support for his power-sharing government. Likely donors still fear that too much of their cash would be stolen and squandered by Mr Mugabe's entrenched cronies. Mr Obama pledged $73m in humanitarian aid when he met Mr Tsvangirai. But most of this is not new money and the American president stressed that it would go "directly to the Zimbabwean people" and nowhere near the government.

Don't give it to the bad guy

Mr Obama also refused to lift the personal sanctions imposed on Mr Mugabe and other members of his regime nine years ago. Ms Merkel promised €25m ($35m), but this was also earmarked for education, health and farming. Zimbabwe already gets about $1 billion a year in humanitarian aid, which bypasses the government. A little of this already does go on what could be termed development projects, but for the moment Western governments are keen to spend most of this money on basic help for people who need food, medicine and clean water.

Zimbabwe's government-controlled media are belittling Mr Tsvangirai's tour, first describing it as merely an MDC fund-raising mission, then claiming he was just "on assignment" at the president's behest to press for the removal of sanctions and the restoration of the country's lines of credit—both untrue. None of Mr Obama's praise for the prime minister was mentioned in the state media, which failed even to show pictures of their meeting.

That he has been welcomed by some of the world's most powerful leaders and given a red-carpet treatment wherever he goes is itself a notable advance for Zimbabwe. But at this stage Mr Tsvangirai can hope for little more.

East Africa gets broadband

It may make life easier and cheaper

Jun 18th 2009 | NAIROBI
From The Economist print edition

A new telecoms revolution in the offing

AFP

THE Horn of Africa is one of the last populated bits of the planet without a proper connection to the world wide web. Instead of fibre-optic cable, which provides for cheap phone calls and YouTube-friendly surfing, its 200m or so people have had to rely on satellite links. This has kept international phone calls horribly overpriced and internet access equally extortionate and maddeningly slow.

But last week, in the Kenyan port of Mombasa, a regional communications revolution belatedly got under way when Kenya's president, Mwai Kibaki, plugged in the first of three fibre-optic submarine cables due to make landfall in Kenya in the next few months. They should speed up the connection of Burundi, Rwanda, Tanzania and Uganda, as well as bits of Somalia, Ethiopia and Sudan, to the online world. Laying the cable cost $130m, mostly at the Kenyan government's expense; Mr Kibaki hailed the event for bringing "digital citizenship" to his countrymen.

The new cable will compete with the other two to be welcomed onshore, perhaps later this year. The hope is that the high bandwidth and fierce competition between the three cables will slash costs and help create new business. With a mass of young English-speakers only an hour or two ahead of Europe's time zones, east Africa should, with luck, be well-placed to compete with India and Sri Lanka for back-office work for Western companies. Broadband, say its promoters, will transform the lives of millions in countries such as Kenya and Sudan, almost as dramatically as mobile telephones have done—all the more so because of the parlous state of east Africa's more old-fashioned infrastructure, especially roads and railways.

A few call centres have already got a toehold in the market and expect to expand fast when the cables arrive. Security experts say cybercrime and junk mail may increase too. Still, mobile telephones, not internet cafés, will continue to grow the fastest. The number and quality of handsets should rise. In a couple of years even fairly poor east Africans may be getting knowledge, news and entertainment on robust versions of existing Apple iPhone and Palm Pre models. That, in turn, may prove to be a political as well as economic boon, as information gets shared "horizontally", among people rather than "vertically" via media outlets run by the political and commercial elites.

Rwanda may emerge as a winner. Its president, Paul Kagame, has long identified the internet as a key to his country's development, offering concessions to software companies setting up there. But Kenya also wants to cash in. It has abolished sales tax on computers and in last week's budget ended the sales tax on new mobile phones. It has also let businesses write off bandwidth purchases in the hope of dominating the regional internet market. That may make other countries push companies to drop their prices.

This is all good news for the often embattled east African consumer. But there is a worry over whether the cables will be properly maintained. Some people fear that the wires may be dug up. But few mobile-phone masts have apparently been stolen, so maybe the cables will survive. One idea in Kenya is to recruit spear-carrying Masai herdsmen to graze their cattle and goats on top of the twittering fibre, just as they already guard the oil pipeline that runs across their pastures.

Lynching in Kenya

A routine crime

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Mob justice is alarmingly common but few seem to mind

A LYNCHING took place recently outside an ironmonger's shop in Nairobi, Kenya's capital. It was close to one of the city's fancier shopping centres, early in the morning, with commuters streaming down the road on foot. A man had his mobile phone stolen but managed to lay a hand on the thief just long enough for the crowd to close in. His two accomplices waded in to rescue their man but the mob engulfed them. Stones rained down. Boulders crushed their heads and chests. Then the crowd moved on, became commuters once more, and the police removed three bodies.

Nobody knows how many such lynchings happen in Kenya every year. What is certain is that they are commonplace. Some MPs worry that violence is on the rise as more people lack jobs and young men are frustrated. The lack of statistics is itself telling. Kenya's police chief, Mohammed Ali, says his force strongly discourages vigilantes from taking the law into their own hands and often arrests them. Yet the police are invariably unable or unwilling to intervene against a large mob. Human-rights groups lack the resources to investigate or even record more than a handful of lynchings. The families of those killed often fail to lodge a complaint out of shame or because they do not have enough money to recover the bodies from the mortuary to bury them.

Petty criminals are often lynched in the countryside too. In central Kenya's Kikuyu heartland, some 23 youths were recently killed by vigilantes on suspicion of being members of an outlawed and feared sect known as the Mungiki, who mix Kikuyu tribalism with organised crime. The police say the Mungiki killed 29 villagers in retaliation. A former justice minister, Martha Karua, who castigates the police, says the figure is higher.

Fear of the mob makes fringe groups, including homosexuals and the disabled, wary of pressing their rights, particularly in villages. The trick, they say wryly, is to argue their case without annoying too many people and drawing a crowd.

Witch hunts, which often end in the death of old women, are still common too. If no one intervenes, the hunts can be lethal. In an attack earlier this year in western Kenya's Kisii district, five old people were dragged out of their homes and burned alive. Human-rights groups say several people are killed on suspicion of witchcraft every month in Kisii alone.

Such hunts persist across Africa. Traditional healers often finger alleged witches, whom the mob may then kill. Bouts of hysteria, sometimes presaged by apparently magical occurrences, can lead to hundreds of deaths. Tanzania's government reckons that every year several hundred of its people are lynched on suspicion of witchcraft.

Israel's settlements

Grappling with America

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From The Economist print edition

After the big public speeches come even tougher talks in private

AFTER many millions of people, in the Middle East and elsewhere, watched President Barack Obama and Israel's prime minister, Binyamin Netanyahu, setting out their versions of how to settle the Israeli-Palestinian conflict, the two leaders may now be quietly beginning to negotiate in earnest. The first issue on their joint agenda is America's demand that Israel stop building or expanding settlements in occupied Palestinian territory and should alleviate the hardships of daily life for the millions of Palestinians under its control.

Mr Netanyahu, who says "normal life" in the settlements must go on, meaning that "natural growth" of the population requires building within the confines of the new towns, still seeks to find common ground. He is soon to meet Mr Obama's envoy, George Mitchell, a former senator, in Paris. The prime minister's people say their boss will be more flexible than he sounds. They claim to have had signals from Mr Obama's team that an acceptable settlement freeze could still allow for some buildings to continue to go up, especially in the three or four biggest settlement blocks near the old pre-1967 border, where most of the 280,000-odd Israeli settlers (excluding those in East Jerusalem) reside.

EPA

Telling one nation about two states

When Mr Netanyahu addressed Israelis on June 14th and articulated, for the first time, his acceptance of a two-state solution for Israel and Palestine, it was a big event. His speech was his response to Mr Obama's ten days earlier in Cairo, which sought to put America's relations with the Muslim world on a new footing.

Mr Netanyahu hedged his acceptance of Palestinian independence with copious conditions. The new state, he said, must be demilitarised; it must "recognise Israel as the state of the Jewish people", code for telling Palestinians to renounce a "right of return" for refugees; Israel must have "defensible borders", code for keeping swathes of the West Bank; Jerusalem must "remain the united capital of Israel", despite Palestinian demands to share it.

But then he said the words he had resisted saying for so long: "We will be ready in a future peace agreement to reach a solution where a demilitarised Palestinian state exists alongside the Jewish state." In terms of Israeli politics, especially those of the right-wing-cum-religious block that put Mr Netanyahu in power and keeps him there, it was significant. The next day his approval ratings surged. His spokesmen said he had voiced Israel's "consensus". The opposition leader, Tzipi Livni, said it was a step in the right direction. Her party, Kadima, won the general election earlier this year but failed to form a ruling coalition with Mr Netanyahu's Likud party because of his refusal to accept the two-state idea.

The Palestinians, on the other hand, railed against him. "It's not a state," said Mustafa Barghouti, a prominent politician. "It's a ghetto." A spokesman for the embattled Palestinian president, Mahmoud Abbas, said Mr Netanyahu had "sabotaged all initiatives, paralysed all efforts being made." The Israeli leader's catalogue of conditions had dashed hopes of a resumption of talks. Egypt's president, Hosni Mubarak, said that Mr Netanyahu's demand that Palestinians first recognise Israel as a Jewish state would "scuttle the chances of peace."

Mr Obama's response was more measured. He praised Mr Netanyahu for his "positive movement". "There were a lot of conditions, and obviously working through the conditions…that's exactly what negotiations are supposed to be about," said the president. "But what we're seeing is at least the possibility that we can restart serious talks."

But Mr Obama again insisted that all settlement-building must stop. For Palestinians and the wider Arab world, and for Israeli public opinion too, this issue will be the first big test of the American president's determination to seek to make peace in the Middle East.

Two past Democratic presidents, who both failed to curb settlement-building, cheered him on. “Based on my experience with Mr Netanyahu, he did what he thought he had to do to keep the ball rolling,” said Bill Clinton. Jimmy Carter, who brokered peace between Israel and Egypt 30 years ago, assailed Mr Netanyahu for raising new obstacles to peace. Still, he told Israeli members of parliament that the differences between their prime minister and Mr Obama were narrower than those “between me and Prime Minister Menachem Begin when he was first elected, but we gave ground on both sides and we sought common ground.”

An adjustable border, maybe

Brushing aside Mr Obama's boycott of Hamas, the Palestinian Islamist movement that still refuses to recognise Israel, Mr Carter met some of its leaders in the Gaza Strip, which Hamas rules. But he also visited Gush Etzion, a large Israeli settlement complex on Palestinian land just south of Jerusalem, and said he saw it as a part of Israel in a future peace treaty, presumably with the Palestinians being compensated with land swaps. This was a reminder that many of the issues Mr Netanyahu framed assertively in his speech as Israeli demands and conditions have been haggled over and largely resolved in years of negotiation between the two sides.

Israeli officials also say they are reviewing the policy that bars building material and many consumer goods from being taken into Gaza. Israel's main purpose, they say, is to weaken Hamas's hold there. But the continuing partial siege may, the officials suggested, be counter-productive. In his Cairo speech, Mr Obama had insisted that “the continuing humanitarian crisis in Gaza does not serve Israel's security” and demanded “concrete steps” to ease life for its Palestinian inhabitants.

Mr Mitchell will urge Mr Netanyahu to loosen the border crossings into Gaza and remove at least some of the 600 or so road blocks that impede Palestinian travel in the West Bank. Over the years, Israel has cited many reasons, mostly security-linked, to ignore or reject such demands. Messrs Obama and Mitchell still think it worth making them. If rebuffed, they may even take measures to show their displeasure.

France and Africa

They came to bury him, not to praise him

Jun 18th 2009 | PARIS
From The Economist print edition

A funeral in Gabon is a test of how fast and how far Nicolas Sarkozy is changing France's policy towards Africa

AFP

TWO French presidents, one serving (Nicolas Sarkozy), one retired (Jacques Chirac), a foreign minister (Bernard Kouchner), plus a clutch of current and former ministers and other dignitaries. The weight of the French delegation that flew from Paris to Libreville for the funeral on June 16th of Omar Bongo Ondimba, Africa's longest-serving leader and object of a big corruption case in France, reflects the close-knit ties the country has kept with leaders of former African colonies, however unsavoury. But did so many French bigwigs go to Gabon to praise what they like to call *françafrique*—or to bury it, along with Mr Bongo (see obituary)?

Before his election in 2007 Mr Sarkozy promised to loosen France's complicit bonds to African leaders, calling them "networks of a bygone era". French-African ties, he argued, needed to be more transparent and less personal, based on respect not paternalism. The post-colonial web of petrodollars, political influence and business contracts, which linked French leaders of both left and right to their African counterparts, had come to discredit France. This was starkly exposed during the 2002-03 corruption trial involving Elf-Aquitaine, an oil company, in which several French bosses were jailed. An echo from that era could be heard recently when one former French president, Valéry Giscard d'Estaing, accused another, Mr Chirac, of receiving party finance from Mr Bongo in 1981—a charge that Mr Chirac emphatically denies.

Mr Sarkozy had other reasons to reconsider France's Africa policy. Thanks to its permanent military bases on the continent (see map) and longstanding bilateral defence accords with many ex-colonies, France has often sought to play the role of regional gendarme. It still has 1,350 troops in Chad, where they were the largest part of a European Union force, sent in largely to support the army against rebels and to protect refugees from Darfur. Yet France is not enjoying the return it once did from its peacekeeping. Commercially it faces Chinese competition: China has overtaken France as sub-Saharan Africa's top trading partner. So France has been picking up the security tab and getting a bad press, but losing out on both business and credibility.

Mr Sarkozy's promised fresh start has had only mixed success. He caused widespread offence in his first big speech in Senegal in 2007 by declaring that "the tragedy of Africa is that the African has not fully entered into history," describing how the African peasant lived according to natural rhythms with "no place...for the idea of progress." The indignation this prompted was only partly soothed by warmer words in a later speech in South Africa. Mr Sarkozy left many in Africa with the impression that he saw the continent as a hopeless nuisance—and that his real interest was tighter controls on visas and immigration to France.

Another episode last year hinted at business as usual. Jean-Marie Bockel, his overseas-aid minister, was moved to another job. His error? A bold speech, arguing for the need "to sign the death warrant for *françafrique*" and denouncing patronage and wasted public money. Mr Bockel lost his job, according to Mr Bongo's lawyer, Robert Bourgi, at the request of Mr Bongo himself. "Bockel hadn't understood anything about Africa," Mr Bourgi told *Le Point*, a French magazine. "He had to go."

Yet in other ways Mr Sarkozy has genuinely tried to ease France out of old habits, notably in defence. Last month he opened a military base in Abu Dhabi, just across the water from Iran, where France has no colonial ties. The establishment of this base, France's first in the Gulf, followed a strategic defence review that called for a reorientation of overseas defence efforts away from military help for former colonies towards a "strategic arc" running through the Mediterranean to the Horn of Africa, the Gulf and on to South Asia.

The French are keen to stress that this does not constitute a "withdrawal" from Africa. Yet they also plan to close one (as yet unspecified) of their three permanent African military bases—in Djibouti, Senegal and Gabon. A one-time base in Côte d'Ivoire has been downgraded to a temporary "overseas mission", and wound down from 2,400 troops to 1,150. Bilateral defence agreements, which spread suspicion among young Africans about France's role in propping up dodgy leaders, are to be updated and made public. "This is not a retreat from Africa," comments François Heisbourg, director of the Foundation for Strategic Research, who took part in the defence review. "But we are saying that Africa will no longer be number one."

One test of France's new approach will be the succession to Mr Bongo. In the old days French presidents would handpick leaders, running African affairs from an office in the Elysée. Indeed, Charles de Gaulle and his "Monsieur Afrique", Jacques Foccart, installed Mr Bongo himself in 1967. In Paris this week Mr Kouchner vowed that "*françafrique* is finished". The Gabonese, he insisted, had to decide on a new leader themselves. He added that "the French army will never back a government against the opposition." Yet with various members of the Bongo clan manoeuvring for power, it remains to be seen if the French can resist meddling altogether.

Another test may be a corruption case against three African leaders (including the deceased Mr Bongo). The complaint was first filed by the French branch of Transparency International, an anti-corruption group. It involves charges of embezzlement and the misuse of public money. A preliminary inquiry showed that Mr Bongo, or members of his family, had no fewer than 39 French properties (many of them in swanky Paris districts), nine cars and 70 bank accounts in France. The lawsuit has had a bumpy ride. The Paris public prosecutor, who answers to the Ministry of Justice, dropped the original case. But last month France's top investigating magistrate ruled that it should be reopened. The Paris public prosecutor has since challenged this ruling; a verdict by an appeal court is due in the autumn.

In many ways Mr Bongo was the epitome of *françafrique*, the mastermind behind all Franco-African networks. His departure, combined with Mr Sarkozy's reorientation of France's Africa policy, is sure to weaken the old personal relationships and may usher in a new era. How fast and how far is another matter. "France's relations with Africa will be increasingly normalised," says Antoine Glaser, a French African specialist and co-author of a book on Mr Sarkozy's policy towards Africa. "But *françafrique* is like an ocean liner: you can't just stop it from one day to the next."

Silvio Berlusconi and the press

Language problems

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Italy's prime minister campaigns against the foreign media

Reuters

Please don't read all about it

NO POLITICIAN likes a critical press and Silvio Berlusconi, Italy's prime minister, is no exception. In recent weeks he has come in for close scrutiny by foreign journalists, and what they have written has not made pleasant reading. Yet the knocks to his standing are partly of his own making. Questions hang over his relations with young women and with David Mills, a British lawyer paid by him and recently convicted of giving false evidence in his favour (Mr Mills is appealing). Mr Berlusconi tried to stop publication of photographs of guests at his Sardinian villa. He said that this would be an invasion of privacy, but the foreign media see it is part of a pattern that betrays a dislike of a free press.

Mr Berlusconi believes that the best form of defence is attack. Last month his foreign minister called a critical leading article in the *Financial Times*, a British business newspaper (and part-owner of *The Economist*), bad and dishonest journalism. Early this month Mr Berlusconi himself accused the foreign press of being at the service of the centre-left opposition. He has attacked newspapers owned by Rupert Murdoch, especially the *Times*, for their recent highly critical coverage. *Il Giornale*, a newspaper owned by Mr Berlusconi's brother, has described the work of the foreign press as poison and lies, pointing especially at publications based in Britain, France, Germany and Spain.

Some Italian ambassadors have been putting pressure on media hostile to Mr Berlusconi. The Italian ambassador in Madrid wrote to the newspaper *El País* to complain of a "systematic campaign of demolition of Italy's image". A foreign journalist in Rome was recently summoned to the foreign ministry. Mr Berlusconi's staff have tried to get one foreign ambassador to bring journalists from his country into line. Yet Mr Berlusconi and his supporters refuse to engage directly with critics. Foreign correspondents complain that it is often impossible to secure interviews with any ministers in the government.

Some journalists believe their telephones are tapped. And the threat of legal action is constant. Mr Berlusconi's lawyer is bringing an action against *El País* because it published the Sardinian photographs. Until Mr Berlusconi came along, Italian prime ministers tended not to sue newspapers. Mr Berlusconi sues plenty (including *The Economist*). He has all the power that comes from great personal wealth, extensive media and publishing interests and control over commercial television, as well as influence on state-owned broadcasting. On June 13th he issued a call to Italian businessmen (later withdrawn) not to place advertising with critical domestic publications.

The prime minister also has a habit of not answering questions. In 2002 he refused to help prosecutors in an anti-Mafia case. More than 50 questions that *The Economist* first sent him in April 2001 remain unanswered. Recently Mr Berlusconi failed to respond to ten questions put by *La Repubblica* over his relationship with a young woman, Noemi Letizia.

As he prepares to chair a summit of G8 rich countries in L'Aquila, Mr Berlusconi might want to consider the effect that his attacks on the foreign press have both on his image and on that of his country.

Russia and Western clubs

No thanks, Geneva

Jun 18th 2009 | MOSCOW
From The Economist print edition

Why Russia is turning its back on the World Trade Organisation

IT HAD become almost a ritual. Every year Russian officials promised that by the end of the following year their country would complete the negotiations to join the World Trade Organisation. Every year the timetable slipped by another year. But now Vladimir Putin, Russia's prime minister, has broken with the ritual by announcing that, after 16 years of trying to get in, Russia no longer wants to join the WTO on its own but only as part of a customs union that it has forged with Belarus and Kazakhstan. The turnaround shocked trade negotiators on both sides, who only weeks ago were trying to iron out the last wrinkles in a deal.

Why the change? The Kremlin may just be fed up with endless new demands and delays. After last August's war with Georgia, Mr Putin accused the West of politicising the trade talks and said that Russia would not be pushed around. Both Ukraine and Georgia, two former Soviet republics that cause big headaches in the Kremlin, are now in the WTO, leaving Russia behind (and, not incidentally, acquiring a veto over its membership). By making his announcement before Barack Obama's visit to Moscow, Mr Putin removed an easy concession the American president might have offered. "We really thought we could have completed [the talks] by the end of the year," said a senior American official.

In practical terms Russia will lose little. It exports mainly oil and gas, which are largely not covered by the WTO. Being outside the organisation for a bit longer gives it more freedom to raise import duties on second-hand cars or export duties on timber. Some observers suggest that the Kremlin was never truly comfortable with the idea of free trade and saw the rules as a nuisance rather than a stimulus to restructure the economy.

Yet Russia's aspiration to membership, which in turn opened up the prospect of joining the Paris-based OECD club of rich countries, demonstrated its desire for integration into the global economic system. Now the Kremlin seems to prefer being a distinct regional power that can offer alternative economic and military institutions and alliances to the West's. Mr Putin has long argued that international organisations such as the WTO and the International Monetary Fund have outlived their day and should be supplemented or even replaced by regional clubs. In the multipolar world that Russia advocates, it sees itself as a centre of regional influence. A military alliance between Russia and Uzbekistan, Belarus, Armenia, Kazakhstan, Kyrgyzstan and Tajikistan, called the Collective Security Treaty Organisation (CSTO), should be "no worse than NATO", Dmitry Medvedev, Russia's president, argued recently.

Russia sees any foreign project that touches the former Soviet Union, including the European Union's new eastern partnership, as a direct challenge. Yet the bigger threat to its ambitions to reassert regional influence lies in its own attitude towards the neighbours. Even as it was signing a customs union with Belarus, Russia imposed a ban on Belarusian milk products, which it claimed did not meet its new packaging rules (rather as it once argued that Georgian wine, fruit and mineral water were of substandard quality). But Alyaksandr Lukashenka, the autocratic president of Belarus, interpreted this (probably accurately) as a punishment for being rude about Russia and refusing to back its policy of recognising the independence of the Georgian territories of Abkhazia and South Ossetia.

Mr Lukashenka is known for his own blackmailing tactics. When Alexei Kudrin, Russia's finance minister, questioned Belarus's solvency and withheld a $500m loan offer a few weeks ago, Mr Lukashenka hit back by saying: "If it does not work with Russia…we will have to try our luck in another part of the planet." In response to the milk ban, he boycotted the latest CSTO summit, insisting that talk of collective security against the background of trade wars waged by some CSTO members against others made a mockery of common sense. Fyodor Lukyanov, a foreign-policy pundit in Moscow, commented that, as soon as the CSTO ceased functioning as a mere symbol of loyalty to Russia and began to set concrete goals, "it became clear how little the organisation met the real interest of its members."

Economist.com WORLD EUROPE

Hungary's opposition

A nasty party

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From The Economist print edition

The centre-right frets over the rise of the far right

AFP

Jobbik's yobs march on

VIKTOR ORBAN, leader of Hungary's centre-right Fidesz party, should be celebrating. His party has just won 14 of Hungary's 22 seats in the European Parliament. The ruling Socialists, stricken by scandal and economic crisis, took only four. But Mr Orban is worried. For the other big winner was the far-right Jobbik party, with 427,000 votes and three seats. Supported both by far-right voters and by disgruntled ex-socialists, Jobbik is the big new thing in Hungarian politics.

The party did best in the country's rundown, often jobless eastern regions, where it played on growing fears of crime, which it linked to the Roma (Gypsy) minority. Jobbik denies anti-Roma racism; it says it is just against gypsy criminals. But the badges, black trousers and heavy boots of its uniformed wing, the Magyar Garda (Hungarian Guard), which marches in formation against Roma wrongdoers, evoke unhappy memories of Hungary's past.

Jobbik's public face is Krisztina Morvai, a blonde, telegenic law professor, noted for both her forthright feminism and her vituperative attacks on Israel. A message posted under her name on an internet forum demanded that Hungarian Jews should play with their "tiny circumcised tails" instead of attacking her. Ms Morvai declines to discuss the matter. Jobbik says it will not comment on private correspondence.

Mr Orban has been moving Fidesz smartly towards the centre in the run-up to next year's election, which polls suggest he will win easily. He wants to lose the reputation he acquired in previous years for irresponsibility in both foreign and economic policy. He has firmly denounced Jobbik's extremism.

Yet critics say Fidesz is reaping what it sowed. One charge is that its broad-tent approach to the nationalist fringe in the past nurtured Jobbik. Fidesz also sometimes co-operates with the far right in local government. And it shares with Jobbik a fondness for extra-parliamentary protests. These started with riots against the then Socialist government of Ferenc Gyurcsany in 2006. Whenever he rose to speak in parliament, Fidesz members walked out.

Fault may have lain on both sides, but the language of politics in Hungary has certainly become sharply confrontational. Extremist websites publish the names and contact details of journalists, Roma activists and artists who arouse their ire. They even blame Jews for the decision to pull down a statue of a Turul, a mythical falcon-like bird that had been illegally erected in Budapest.

This week somebody scattered pigs' feet among the riverside memorial, composed of metal shoes, that marks a Nazi atrocity in 1944 when Jews were driven into the waters of the Danube and shot. Outsiders worry about prejudice becoming respectable. The British Embassy, for example, is sponsoring a Music Against Racism event at a Budapest festival in August. Perhaps Mr Orban should put in an appearance.

Economist.com WORLD EUROPE

Turkey and its army

Restive colonels and generals

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From The Economist print edition

New evidence of old anti-government conspiracies within the army

OLD habits die hard. No institution in Turkey lives up to that adage more than its meddlesome army, which is embroiled in yet another row with the ruling Justice and Development (AK) Party. The latest mischief-making concerns an alleged plan that was hatched last April to overthrow AK and to incriminate Turkey's largest and most influential Islamic brotherhood, led by a moderate preacher called Fetullah Gulen.

A copy of the "Plan to Combat Islamic Fundamentalism" was published by *Taraf*, a liberal daily newspaper, on June 12th. It promptly sparked a political storm that has left the army on the defensive. Signed by Dursun Cicek, a colonel serving in the army's psychological warfare unit, the plan calls for "mobilising agents" within AK to discredit the party through their actions and words. Worse, it speaks of planting weapons in the homes of members of Mr Gulen's movement, with a view to demonstrating that they are "terrorists" with links to separatist Kurdish PKK rebels.

Another aim of the plan was apparently to use the media to galvanise nationalist support against Armenia and Greece. And the authors also wanted to clear the names of officers who are being prosecuted for past coup plots against AK as part of the so-called Ergenekon conspiracy.

Skulduggery of this kind is not exactly new in Turkey. The army, which has seized power three times directly, used similar tactics to unseat the country's first Islamist-led government in 1997. In 2004 a group of generals cooked up various schemes to overthrow AK on the grounds that it was seeking to introduce religious rule. Yet for once the government is fighting back. It has laid a formal complaint with public prosecutors, calling for a full criminal investigation into an attempted coup. Colonel Cicek, who protests his innocence, has been called to testify before prosecutors dealing with the Ergenekon case. "If the allegations are true, the situation is dire," declared Recep Tayyip Erdogan, the prime minister, after a 70-minute meeting with Ilker Basbug, the chief of the general staff.

Reuters

Basbug and Erdogan, sailing into the sun

The general denies all knowledge of the affair, but he has promised to punish any of his men who are guilty. The general staff has launched its own investigation. But army prosecutors have rushed to declare that there is no evidence that the plan was devised at its headquarters, even if they could not refute its existence. "This statement has only reinforced suspicions," sneered Bekir Bozdag, an AK whip.

If the plot was really conceived without General Basbug's knowledge, it was probably the act of a group of renegade officers within the army. This theory was buttressed by a recently retired general, who told *Taraf*

that he knew of “five or six people” who were bent on unseating AK, adding that he had warned General Basbug of their plans. Another less likely story is that the police, heavily penetrated by Gulenists, forged the document to embarrass the army.

Certainly there is little trust between the army, the government and the security services. Many hope the affair will give Mr Basbug a chance to prove his democratic credentials and root out rogue elements once and for all. Yet the signs are not encouraging. Colonel Cicek has not been suspended during the inquiry. And army prosecutors have slapped a legally dubious ban on any coverage of it.

The onus is now on Mr Erdogan to insist to the generals that they must take orders from him and not the other way round. His meeting with General Basbug suggests that he may be more interested in cutting deals. That is what he supposedly did with the general’s predecessor, Yasar Buyukanit, who had issued a statement on the internet in April 2007 threatening to seize power. Soon afterwards Mr Erdogan met General Buyukanit for two hours. Both vowed secrecy, prompting speculation of a truce.

This new scandal suggests that, no matter how many conspiracies it survives, AK will remain a target of those who resent its encroachment on their traditional bastions of power. Ominously, the prosecutor who launched the court closure case against AK in 2008 has now made the bizarre complaint that the government is focusing “too much on economic growth” at the expense of secularism. He has also spoken against proposed constitutional changes that would make it more difficult to ban political parties. Mr Erdogan needs to stick to his guns and push through these changes. The best response to an attack on democracy is more democracy.

Charlemagne

The danger of unemployment

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Rising unemployment will test many governments' commitment to labour reforms

Illustration by Peter Schrank

SO FAR this recession has not been all bad for Europe. Above all, the past few months have looked good for the European concept of "flexicurity". First coined in Denmark, this is an appalling word for an appealing idea: that Europeans will tolerate more flexible labour markets (ie, quicker firing) so long as they have the security of generous social assistance if things go wrong.

Admittedly France has seen a spate of "bossnappings" by angry workers; and politicians are unpopular in such hard-hit places as Latvia, which is imposing cuts of 20% or more in public-sector pay. But there has been no sign of the continent-wide unrest that gloomsters once predicted. Although unemployment is soaring in countries like Spain, in Germany it has not risen as much as it might have done, given the decline in GDP.

For several months companies, employees and governments have absorbed much of the shock of the recession through schemes like short-time working, unpaid leave, training leave or by using production workers to do repairs. But talk to officials in Brussels or business chiefs across the continent, and anxiety is building. These job-saving schemes were essentially bets on a short recession. Companies are now telling the politicians that, if the economy does not pick up by the autumn, some big redundancies loom.

Assuming that a recovery does not materialise this year, the European model of flexicurity will face three overlapping threats. The first involves money. Several European Union countries have asked their citizens to accept flexible labour laws, which make hiring and firing easy, on the basis that this will lead to economic good health. Yet some may struggle to keep "the security side of the bargain," says Jakob von Weizsäcker of Bruegel, a Brussels-based think-tank. If the crisis drags on or deepens, he frets that governments may have to choose between draconian cuts in welfare and fiscal irresponsibility.

The second threat involves cohesion, and the different things that flexicurity means. To put it simply, the two halves of the bargain have been unevenly shared out: some people have provided Europe with much of its flexibility while others have hogged most of the security. Consider the car industry, where a gap yawns between a handful of countries with their own national carmakers, and others where cars are merely assembled. The French government has talked of giving aid to carmakers that "bring jobs home" to France; the German government appeared to choose an Austro-Russian consortium to rescue Opel in part because it promised to keep factories and jobs in Germany, at the expense of factories elsewhere.

Inequalities yawn in labour markets too. In countries like Spain, firms have laid off employees on temporary contracts (many of them young or migrants), rather than spending a fortune shedding staff on permanent contracts, which in Spain offer up to 45 days' redundancy pay for every year worked.

There are also big regional differences in welfare benefits. European Commission officials estimate that in most of western Europe, between 80% and 90% of the unemployed are entitled to some social assistance. In southern Europe the coverage is patchier. And in parts of eastern and central Europe as few as 30% of jobless citizens receive significant welfare payments (though the coverage is broader in Slovenia and the Czech Republic).

The third and biggest threat to flexicurity is that it will prove politically costly to defend if unemployment takes off. Across Europe reformist officials share the same fear: that governments will revert to "solving" unemployment by easing workers out of the labour market altogether. They have form. In the downturns of the 1980s and early 1990s, many millions of workers were bundled into early retirement or on to disability schemes. For governments, the attractions were clear, because such departures had an instant effect on the unemployment figures. Early retirement also seemed kinder than mass lay-offs. And restructuring had a pleasing air of modernity about it: Europe was moving upmarket and waving goodbye to old labour-intensive businesses like building ships or digging coal.

A lumpen proletariat

Back then many politicians, unions and workers also fell for the "lump of labour" fallacy, which suggests that there is a fixed amount of work to be done at any given time, available for slicing up and sharing out according to policymakers' will. So waving goodbye to 57-year-olds would automatically free up jobs for the young. (The same thinking led French Socialists to dream up the 35-hour week, a measure now hollowed out by a myriad of exemptions.) To companies, getting rid of their oldest workers was also attractive. They tended to be paid according to seniority, rather than productivity, and were costlier to sack.

Only later was this shrinking of the European labour pool revealed as a mistake. When demand picked up, valuable human capital had left the market forever. And terrible damage had been wrought to the solvency of pension systems, just as demographic trends were turning and the continent was ageing fast.

European governments have undertaken a fair number of reforms since then. And thus far few EU leaders have talked openly about encouraging early retirement as a cure for unemployment. Indeed, in countries such as the Netherlands and France, governments have actually done the opposite, reopening public debates on raising the retirement age to safeguard the solvency of their pension systems.

But high unemployment scares politicians more than most other things. Reformers are watching carefully for any signs that the mistakes of the past are about to be repeated. If the recovery takes its time to gather pace, much danger awaits.

Economist.com/blogs/charlemagne

Reforming bank regulation

Turf wars in black tie

Jun 18th 2009
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Plans to avoid another crisis prompt feuding within Britain and with Europe

Bloomberg

THE midsummer dinner with bankers at Mansion House, the Lord Mayor's home in the City of London, offers chancellors of the exchequer a chance to address pressing economic and financial issues. For Alistair Darling (pictured left), who came close to losing his job in Gordon Brown's recent cabinet reshuffle, the very fact that he was there on June 17th was a triumph of sorts. But the occasion was spoilt for him by a public row with the other speaker, Mervyn King (pictured right), governor of the Bank of England.

Both the chancellor and the governor wanted to tell the banking bosses how the financial system could avoid repeating last October's near-death experience. Mr Darling said that the banks needed to put their own houses in order, but he also accepted that better management would not be enough. Financial supervision must be made more effective.

There is broad agreement that this will require two main reforms. First, supervision must be top-down as well as bottom-up. In the jargon of the hour, it should be "macroprudential", monitoring the financial system as a whole, as well as "microprudential", keeping an eye on individual firms. The new overseers will identify systemic risks such as dangerous credit surges and counter them, for example by telling banks to hold more capital. And second, existing microprudential supervision must be smarter and tougher.

But who should be in charge of a reformed regulatory system? The question is politically charged because it calls into question Mr Brown's seminal reform 12 years ago. As chancellor, he freed the Bank of England to set interest rates but handed its supervisory powers over banks to the Financial Services Authority.

Small wonder, then, that Mr Darling announced no big regulatory shake-up as his Treasury prepares a policy paper on reform that is due to be made public shortly. Instead he pointed out that no one model of regulation had insulated a country from the crisis. Judgments based on clear analysis mattered more than rejigging institutions to implement a new approach: "to concentrate only on institutions seems to me to miss the point".

Mr King could hardly have dissented more bluntly. He accepted that the central bank had been given new powers to deal with banks that run into trouble, and that it now had a statutory responsibility for financial stability. But more tools were needed. Likening the central bank to a church, he feared that its congregation would disregard the vicar's exhortations, however thunderous: "Experience suggests that attempts to

encourage a better life through the power of voice is not enough."

In effect, then, Mr King said that institutions do matter, that the institution which should be in charge of macroprudential regulation is the central bank and that it needs a new toolkit. Embarrassingly for the Labour government, that puts the governor squarely in the camp of the Conservatives, who have already argued that the Bank of England should run the new-style macroprudential regulation.

The governor also crossed swords with the chancellor on whether more fundamental changes were needed. He said that banks thought to be too big to fail are too big. Mr Darling, by contrast, maintained that the solution to this problem was not as simple as restricting the size of banks.

If there is a war over who should be the supervisory supremo in Britain, there is also a battle within Europe. High on the agenda of the meeting of European Union leaders on June 18th and 19th was a proposal for far-reaching reforms to shift more regulatory power to the European level. The case for change is that the financial crisis has exposed a dangerous gap: many markets and banks operate across Europe but supervision remains a national affair.

As in Britain, the reforms would introduce macroprudential supervision. A "European Systemic Risk Board" (ESRB) would sound the alarm over dangers to financial stability throughout the EU and suggest how to avert them. The board would include the governors of the EU's national central banks and be chaired by the president of the European Central Bank (ECB). In addition, a "European System of Financial Supervisors" would push for more convergence in financial regulations, exert more influence over national supervisors and, where necessary, resolve differences among them.

Mr Darling accepts that there should be more co-operation both in Europe and globally to promote financial stability. He has argued the case for a body to set financial standards across the EU. But he and Mr Brown are unhappy with both the European proposals. Although the ESRB would lack legally binding powers, the Treasury dislikes the idea of the ECB's president chairing what would be the EU's macroprudential overlord. And it believes conventional banking supervision must remain a sovereign responsibility. National taxpayers are called upon if banks run into trouble and have to be bailed out.

But a government beset by electoral setbacks and party in-fighting is on the back foot in seeking to temper the plan. When European finance ministers met on June 9th, they recognised that European supervisory rulings should not impinge on national fiscal sovereignty. But the substance of the reforms still looks set to go ahead.

But the most awkward problem now for Mr Darling is how to respond to Mr King's pitch for more power. If he gives ground, this will be interpreted as weakness. But if he tries to muddle through then Tory counter-proposals will be given added weight by the governor's open dissatisfaction with current arrangements. Mr King may have likened himself to a vicar, but the chancellor may well regard him as a turbulent priest.

Economist.com WORLD BRITAIN

The future of the BBC

Auntie stumbling?

Jun 18th 2009
From The Economist print edition

A glimpse of a less imperious future for the national broadcaster

Illustration by S. Kambayashi

HOSTILE governments and resentful competitors have never managed to knock the British Broadcasting Corporation (BBC) off its privileged perch. The public-service broadcaster remains a behemoth with tentacles in fields as disparate as publishing and the internet, all paid for by an international anomaly: a licence fee levied on any household in Britain with a television that receives broadcasts.

Yet the government's latest meditation on the future of British media, a report on "Digital Britain" published on June 16th, contains the seeds of a more challenging future for the corporation. It suggests that surplus revenue earmarked for the switchover to digital television could be given to other broadcasters to pay for regional news, as well as used to provide universal broadband access to the internet (see article). The sums involved in this "top-slicing" of the licence fee amount to a sliver of the £3.4 billion ($5.6 billion) it raises a year. But the idea is tenaciously opposed by the BBC, which frets about the precedent of letting other producers in on the money.

In an effort to save Channel 4, a prolific source of worthy output whose advertising revenues are vanishing, the government is proposing a partnership between it and BBC Worldwide, the corporation's commercial arm. The move reflects the government's commitment to the idea that public-service broadcasting should come from more than one source. Again, the BBC is reluctant, fearing a loss of control.

Despite the corporation's shrill response, the reforms proposed by Lord Carter, the communications minister, are only nudges in a new direction. The pace of change is likely to quicken under a Conservative government. Aside from a public spat in the aftermath of the Iraq war, Labour's long years in power have been a boon to the BBC. In 2000 the government agreed to a licence-fee settlement giving rises greater than inflation. Even the less generous deal six years later was privately regarded as satisfactory by the broadcaster. Commercial rivals have bemoaned the revolving door between the government and the BBC. Ben Bradshaw, the new culture secretary, is a former BBC journalist. His predecessor but one, James Purnell, was its head of corporate planning. Those who have made the reverse journey include Gavyn Davies, a former Labour adviser who became chairman of the BBC.

The Conservatives respect the paternalistic ideals of Lord Reith, a founder of the corporation, but are warier of the institution itself. Jeremy Hunt, the shadow culture secretary, who is highly regarded by the Tory leadership, supports the licence fee as part of a mixed economy for broadcasting, along with advertising and subscriptions. But he wanted it frozen this year because of the recession. He also favours a more transparent BBC: he thinks its accounts should be fully audited and expenditure, including salaries, published online. Though they stop short of pledging to put it fully under Ofcom, which regulates communications, the Conservatives think it should be overseen by a more independent body than the BBC Trust, which does the job now. Many Tories, who sense a liberal-left slant at the BBC, want a tougher line. But Mr Hunt favours practical reforms over the open conflict with the broadcaster that characterised the Thatcher years.

The BBC is cutting costs and re-examining the embarrassingly lucrative contracts of some of its stars. And if its regional news services and vast website are crowding out competition, it is not clear the public minds particularly.

But a prospective Conservative government is not the only cloud on its horizon. Technological developments such as online television and the proliferation of channels are making it harder to defend the regressive licence fee. An Ipsos MORI poll in August showed a public no longer squarely behind the status quo: 37% said the licence fee was not the right way to fund the BBC, and 47% denied it was good value. In perhaps the grimmest omen for the corporation, its strongest support was among those aged over 65.

The future of broadband

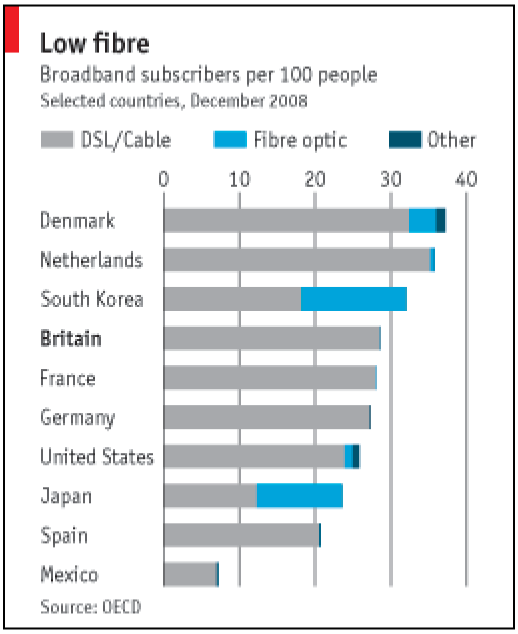
And access for all

Jun 18th 2009
From The Economist print edition

Fast internet for everyone, and a new tax to help pay for it

THE 2,200-foot Royal Albert railway bridge, which links Cornwall to Devon across the river Tamar, is one of the best-loved achievements of Isambard Kingdom Brunel, a swashbuckling Victorian engineer. It is also a nice illustration of the risks of penny-pinching when building infrastructure. The bridge is designed to carry rails spaced seven feet (roughly two metres) apart, the standard used by Brunel on his Great Western Railway. But rails used by firms in other parts of the country were separated by less than five feet, and when the time came in 1846 for a parliamentary commission to decide on a national standard, it plumped for the cheaper, narrower option. Had it decided in Brunel's favour, modern Britain's slow and crowded trains would be bigger, smoother and faster.

But false economies are obvious only in retrospect. When building infrastructure, governments walk a tricky line between counterproductive tight-fistedness and unnecessary gold-plating. A good modern example is internet access. On June 16th Lord Carter, the communications minister, announced plans to provide high-speed internet for all, as part of a sprawling report on "Digital Britain" that included musings on the BBC (see article).



Britain is already comparatively well-wired. It scores highly on access to broadband (see chart) but less well on speed, where it trails countries such as Japan and South Korea that offer high-capacity fibre-optic cable to many of their citizens. Internet access is not nationwide: those living far from a telephone exchange get lower speeds (or no connection at all). Lord Carter wants to spend £200m ($330m) to ensure that everyone in Britain has access to the internet at a minimum speed of 2 megabits per second (Mbps) by 2012.

Speeds should improve in future as Virgin Media, a cable firm, and BT, the old state telephone monopoly, upgrade their networks. Virgin Media offers speeds up to 50Mbps to houses served by its cable network (around half the total), and is exploring the possibility of going faster still. BT wants to run fibre-optic cables to local telephone cabinets, rather than to individual houses, and reckons it can offer 40Mbps.

But Virgin's network is limited and fibre-optic cables are expensive. The two firms can profitably reach only around two-thirds of the population, reckons Matt Yardley of Analysys Mason, a consultancy that helped to prepare the report. Connecting the rest at high speed will cost around £3 billion. So Lord Carter surprised the broadband industry by proposing a £6 annual tax on telephone lines, raising around £150m. That will be used to bring "next generation broadband" (a term left undefined, but probably an expansion of the BT scheme) by 2017 to the third of the country the private sector will struggle to reach.

Spending public money on whizzy new networks appeals to technophiles, but the benefits are not clear for others. Video-on-demand is the usual justification, but Sky, a satellite-TV firm, already offers such a service, and the BBC's popular iPlayer service runs well enough over the existing network. Boosters claim the benefits of fast internet access cannot be predicted, and that history shows that extra bandwidth generates its own supply of data. Yet evidence from Hong Kong, which already offers speedy connections, suggests that super-high speeds appeal only to a few. And if demand for speed grows, the falling cost of hardware means it will be cheaper to provide in future than it is today.

Could political motives lie behind the largesse? Taxing phone lines and subsidising the underconnected is a departure for a government long content to leave broadband to the market, notes Matthew Howett, an

analyst at Ovum, another consultancy. That leads the cynical to wonder if the report was jazzed up at the last minute in an attempt to win political brownie points for an unpopular government.

Inquiring into the Iraq war

Lessons to learn

Jun 18th 2009
From The Economist print edition

Another inquiry—just not the one the war's critics want

Reuters

The old order changeth

WHEN Gordon Brown told Parliament on June 15th that he was setting up an inquiry into Britain's role in the Iraq war, the prime minister barely mentioned the four preceding inquiries on the same topic. Two committees of MPs and two government-appointed panels of experts had examined aspects of the decision to invade Iraq alongside American forces—and none had satisfied critics of that decision. Instead, Mr Brown found in the 1983 inquiry by Lord Franks into the outbreak of the Falklands war what he called the "best precedent" for an investigation of the origins and conduct of the Iraq war, and the subsequent occupation of that country.

What Mr Brown meant was that this latest inquiry would, like Franks's during the cold war, be held in private. That would protect national security and ensure that evidence would be "full and candid". A public inquiry, he said, would mean delay and "lawyers, lawyers and lawyers". The inquiry under Lord Saville into the "Bloody Sunday" incident—the killing by British forces of civil-rights protesters in Northern Ireland in 1972—is a cautionary tale. It has run for eight years and cost well over £150m ($246m), with no end in sight.

Five "privy councillors"—sworn advisers to the government—will spend a year studying documents and taking evidence, before reporting "as fully as possible". They will not apportion blame, said Mr Brown, but identify "lessons learned". The phrase so neatly encapsulated his notion of their brief that he used it, or minor variants, 17 times during the hour-long parliamentary debate on his announcement.

Pretty much everything about this inquiry was immediately attacked, and not only by opposition parties. Families of servicemen killed in Iraq said that only a public hearing would satisfy them. Retired military types saw no reason why most of the hearings should not be held in public. Observers of all stripes criticised the distinguished panel—a former senior civil servant who had served on a previous inquiry into the war, an ex-diplomat, a historian of Winston Churchill, a professor of war studies and a Kenyan-born member of the House of Lords—as an establishment stitch-up. Others condemned its inability to hear evidence given under oath or compel witnesses to attend.

Mr Brown promptly backtracked, giving the panel flexibility over how it will operate. He also requested that bereaved families be consulted and suggested considering whether testimony might indeed be given under oath.

A sensible compromise, or a chaotic climbdown? The inquiry will not report until after the next election. But it has already embarrassed the prime minister.

Devolution finances

Still evolving

Jun 18th 2009 | EDINBURGH
From The Economist print edition

Scotland is to raise more of the money it spends—whether it wants to or not

PERHAPS the biggest problem in politics is how to match the public's desire for things like roads, hospitals and schools with its dislike of paying the taxes needed to build and run them (see article). That has not worried Scotland's devolved government, however. It has spent lavishly on transport, health care and education: Scottish university students pay less than English ones, and oldsters are cared for free of charge. Content with its block grant of £33 billion from the Treasury in London, the Scottish government has shown no interest in using the single, modest tax-raising power it has: varying the 20% basic rate of personal-income tax by up to three percentage points.

That may be about to change. On June 15th a commission set up under Sir Kenneth Calman, once Britain's chief medical officer, came up with some ideas on how to improve the Scottish Parliament, ten years into devolution. Its chief innovation is suggesting that Scotland raise more of the money it spends, in the hope that fiscal responsibility might make its politicians cannier with taxpayers' cash.

The commission proposes letting the Scottish government vary income-tax rates by 10p in the pound in each tax band. It suggests that London set Scottish rates at 10p less than those for Britain as a whole, and cut its block grant by the amount that the difference in rates might be expected to raise. Scotland's finance minister could then produce a follow-up budget to fill the gap—or not. A few other taxes might also be devolved (mostly minor ones, such as air-passenger duty, and explicitly not big earners such as corporation tax or North Sea oil and gas levies). Sir Kenneth reckons the scheme would put Scotland in charge of raising around 16% of its budget.

The proposals are likely to please both the Scots, by giving them more power over their own affairs, and the English, by reducing the money the Treasury sends north. Gordon Brown at once welcomed the proposals, saying that they would provide a new basis for the political union between Scotland and England. For his part Scotland's first minister, Alex Salmond, briefly looked stunned—inheriting responsibility for taxes in the depths of a recession is a poisoned political chalice—but quickly rallied. He said he might include a vote on the proposals in a referendum on Scottish independence he wants to hold next year. Mr Brown could trump Mr Salmond by rolling the recommendations into a bill with other constitutional reforms before Mr Salmond has a chance. The politics of all this are far from straightforward.

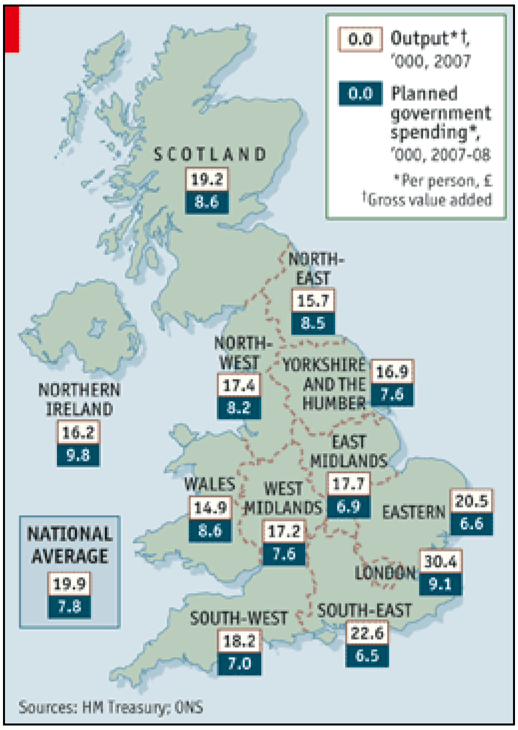
Seceding from Britain is not especially popular in Scotland but Mr Salmond is. The Calman commission was set up in London after his Scottish Nationalist Party (SNP) edged out Labour in the Scottish elections of 2007. The SNP has since won one bye-election and thumped Labour in the European elections on June 4th. The Labour Party looks set for defeat in the general election which must be held by June 2010. Mr Brown may calculate that swift action on the Calman plan could defuse the SNP threat to Labour's Scottish seats.

Whatever its merits, however, the Calman plan fails to address the bigger problem of how public spending is distributed around Britain. Though Scotland is the fourth-wealthiest part of Britain (far richer than England's North-East, for example), it receives, like Wales, the third-biggest dollop of central-government spending per head (see map). Poorer regions gripe, with reason, that this is unfair.

These inequalities arise because the formula for allocating cash to Scotland, Wales and Northern Ireland, introduced in 1978 and based on population, has failed to produce the hoped-for convergence in regional spending. Politicians have added extra cash over the years—usually, in Scotland's case, to appease Nationalist uproar.

Sir Kenneth was not asked to come up with a different formula and

didn't. But pressure to do so is building in other parts of the union. Welsh politicians, convinced that Wales gets a raw deal, have set up a big-name commission to examine the formula's flaws. Its first report is due soon. If it is written with the same cogency as Sir Kenneth's, Mr Brown's regional problems will only get worse.



Applying for asylum

After the backlog, a backlog

Jun 18th 2009
From The Economist print edition

As one mountain of old asylum claims is demolished, a new one grows

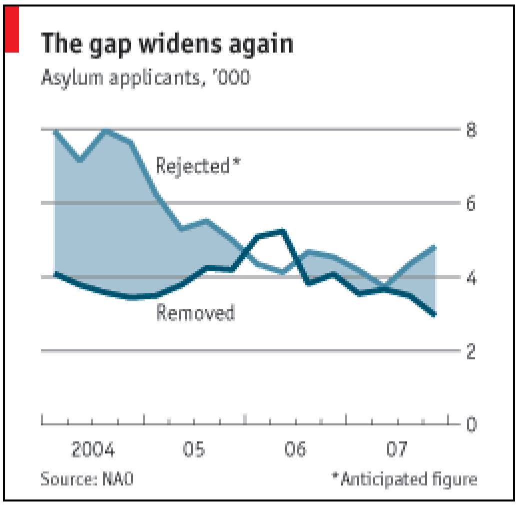
IN 2002 Britain received more asylum applications than any other rich country. More than 84,000 people, plus their dependants, requested sanctuary. Like other Western countries, Britain responded by making it harder to apply: border guards now lie in wait at European ports to intercept would-be asylum-seekers before they can reach British soil, and people from countries such as Zimbabwe may no longer fly to Britain without a visa. The clampdown has worked: last year only 26,000 applications were made.

The dip has provided breathing space for the Home Office, which has been battling a build-up of up to 450,000 unresolved asylum cases, some dating back more than a decade. As well as being inhumane to the applicants, such delays are expensive for the taxpayer: in the year to April 2008, these "legacy" cases cost the Treasury £600m. The bulk of this was spent on providing miserly welfare to asylum-seekers, who are forbidden from working until their cases are decided.

A report by the parliamentary public-accounts committee on June 16th showed that officials are making progress with the old backlog, and shed light on the parlous state of the asylum database. Duplicate entries, missing details and a chaos of crumpled faxes and incompatible IT systems featured large. Nonetheless, last year 155,000 "legacy" cases were polished off. The Home Office hopes to have them all done by 2011, though it suspects that a fifth of them may prove insoluble.

New cases are being handled by a revamped system, which the MPs praised. A single caseworker now handles each application from start to finish, reducing Chinese whispers. Things have speeded up: in 1997 it took an average of 22 months to decide whether to offer someone leave to remain; in 2007 it took seven months.

Yet even at this faster pace, and with applications low, the new system is falling behind. Following a modest increase in applications in 2007, the backlog of new cases (excluding the old "legacy" lump) more than doubled in 12 months, to nearly 9,000 by last summer. Another backlog is forming of people who have not been removed even though their applications were turned down. In January a report by the National Audit Office, a spending watchdog, showed that the number of refused applications was consistently higher than the number being deported (see chart). The ranks of failed asylum-seekers in limbo are swelling.



The Home Office says this is because it is focusing on removing foreign prisoners whose jail term is up. While their cases are pondered they are held in the same immigration removal centres where many failed asylum-seekers are detained before they are shipped out. There are not enough beds for both. The MPs suggested that foreign prisoners could be assessed for deportation while they are still in jail. Refugee charities add that detaining failed asylum- seekers (including children) should only be done as a last resort. Instead, the government is building more detention facilities, and plans to have another 1,626 new places (a 64% increase) by 2013.

The system must smarten up before the quiet period ends. Applications have risen in the past two years following violence in Zimbabwe and Iraq. And a self-imposed bundle of extra work is on the way. Since 2005 refugee status has been awarded on a temporary basis, renewable after five years. Next autumn the first 8,000 people in this category are up for renewal.

Tax havens under pressure

Whiter than white

Jun 18th 2009
From The Economist print edition

Britain's offshore financial centres race for respectability

BERMUDA, a British territory in the North Atlantic, proudly announced this month that it had made it on to the OECD's white list of benign tax regimes. That puts it among the countries that have "substantially implemented" internationally agreed tax standards, as monitored by the OECD, a club of industrial nations. Since January 2007 a stampede of offshore tax havens, many of them British one way or another, have rushed to sign enough bilateral tax-information exchange agreements, known as TIEAs, to get on the white list. The arbitrary threshold is 12.

The Channel Islands (Jersey and Guernsey) and the Isle of Man squeaked in before a meeting of G20 countries in London in April, where tax dodging was on the agenda. The Cayman Islands and British Virgin Islands (BVI), with eight and ten TIEAs respectively, are still on the grey list. All have gone the Nordic route to get TIEAs in a hurry: wooing the Nordic block brings seven TIEAs at one blow, including tie-ups with the Faroe Islands and Greenland.

Alamy

That is forever England

These tiny outcroppings of British authority—dependencies and overseas territories—are a motley crew. They range from the Channel Islands, the Isle of Man and Bermuda, which have legal and financial frameworks roughly like Britain's, to archipelagos with a reputation for corruption. All have made a living by enticing the tax- and publicity-shy through their discretion and low tax rates. All are now under pressure from the OECD, America and the European Union to raise standards of transparency and financial vigilance.

For Britain, which exercises at least nominal sovereignty over these tax havens, their survival matters. The Channel Islands argue that their proximity and similar legal framework bring business to the City of London. More concretely, if a dependency were to fail, Britain would almost certainly have to bail it out. How far British obligations could extend is unclear: Michael Foot, a former British regulator, is due to report on the matter in October.

Many in these havens accept that transparency is coming. The question is when. If they do not pull up their socks, they will lose business. They are the first places foreign governments or private-sector gumshoes look when they are tracking down tax evasion or ill-gotten gains. Several companies have decided to quit Bermuda recently. One of them, a consulting firm called Accenture, cited among other reasons the "continued criticism of companies incorporated in Bermuda". But if the tax havens clean up too fast, they also stand to lose business, to slower-moving rivals such as Liechtenstein or Switzerland, or newly attractive islands in the Pacific.

How much have Britain's far-flung islands to fear in the long run from tougher rules? Jersey is the domicile of choice of many trusts and investment funds; Guernsey and Bermuda are home to insurance firms (Bermuda has the world's biggest cluster of reinsurance companies and the second-biggest of captive-insurance companies). Those businesses will face more big-country competition with the convergence of international standards but are unlikely to be killed, say local sources, because they have other advantages such as greater efficiency. Bermuda, for example, is ahead of most countries in implementing the EU solvency rules for insurance companies that are soon to come in.

But the BVI, which is a postbox for hundreds of thousands of companies, may prove less popular if new American demands for transparency begin to bite. And the Cayman Islands' 9,000 or so hedge funds could well be hit by draft EU rules on alternative-investment managers, which threaten to bar funds registered in offshore places, even well-regulated ones, from being sold into the EU for a bit.

The biggest question for Britain’s offshore tax havens, especially those closest to its coast, is how to deal with the EU’s savings-tax directive, which requires members to exchange tax information automatically. Jersey says it will comply when its foot-dragging EU rivals—Austria, Belgium and Luxembourg—do too, which they must by the end of 2011. Switzerland and Liechtenstein may fall in line then as well. In the meantime the Channel Islands and the Isle of Man, like the foot-draggers, are deducting withholding tax from EU-resident savers anonymously, and answering specific requests for information.

The Cayman Islands, for its part, went for automatic exchange of information from the beginning, after assurances that this would not affect its hedge funds. Liechtenstein is negotiating a more co-operative TIEA with Britain now. Signs, perhaps, that times are truly changing.

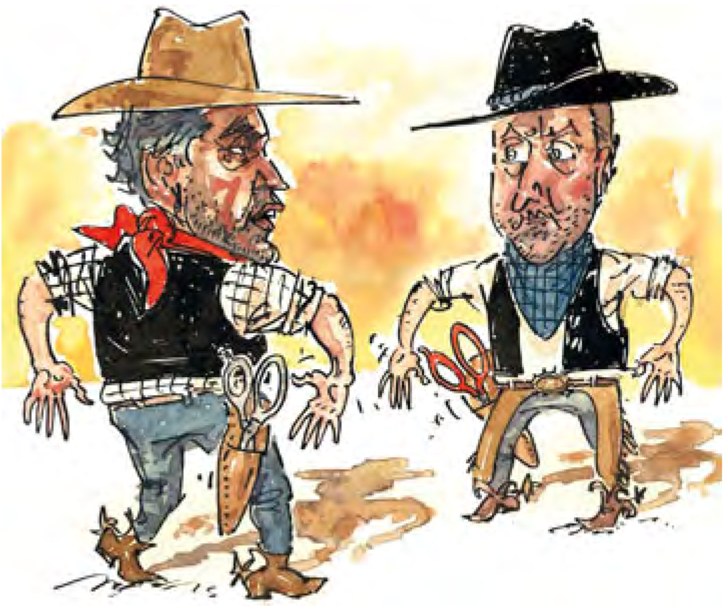
Bagehot

Blowback

Jun 18th 2009
From The Economist print edition

The end of the New Labour orthodoxy on public spending

Illustration by Steve O'Brien



THE doors of the Metro stations in Moscow are lethal—thick, heavy glass with a wicked swing. Yet surprisingly few people hold them open for the passenger behind them. Russia's capital is a tough, atomised, distrustful city: communism, supposed to inculcate brotherly love and self-abnegation, instead bequeathed something like the opposite. The same could be said of some other grand political ideas (militant trade unionism, for example): over-ambitious, impractical and naive, they ultimately backfire.

Something similar may be true of a central tenet of New Labour—that public services should consume an ever-increasing share of national wealth. For more than a decade, espousing that view seemed to be required of any party that wanted to win a general election. That public spending must grow eternally appeared to have become a political orthodoxy. No longer.

Probably New Labour's main contention, before its landslide victory in 1997, was that the "public realm"—hospitals, schools and the rest of Britain's infrastructure—had been gruesomely neglected by the Conservatives. In 1997, it had a point. Tony Blair's manifesto vowed that his ministers would be "wise spenders, not big spenders"; he pledged to abide by Tory expenditure plans for his first two years in office. But the implicit message was of generosity: the campaign's last-day slogan was "24 hours to save the NHS". At the 2001 and 2005 elections, the pitch was starker: Labour would "invest"; the Conservatives would cut.

The Tories' efforts to challenge this doctrine made them political fugitives—literally. In 2001, after speculating about cuts beyond the modest ones his party advocated, Oliver Letwin, a frontbencher, fled to Dorset. In 2005 the party's deputy chairman was sacked for loose talk about cuts. When David Cameron became leader, after a third straight defeat for the Tories, he capitulated, endorsing the government's overall spending proposals. New Labour's idea was cemented as cross-party consensus.

It has taken a savage recession, with state expenditure nudging 48% of GDP and debt heading for £1 trillion ($1.6 trillion), for it to be challenged. The Tories were at first discombobulated by the financial crisis and economic slump, then coy about the consequences, banging on euphemistically about "tough choices". Until Andrew Lansley, the shadow health secretary, baldly predicted 10% cuts for most departments between 2011 and 2014—and Mr Cameron and George Osborne, the shadow chancellor, jumped on this chance for

strategic candour. The Tories should "tell the public the truth", Mr Osborne wrote this week, "that many government departments will face budget cuts."

That, in a way, is stating the bleedin' obvious: Mr Lansley's figure came from the Treasury's own projections for spending and debt repayment. And Tory candour does not yet extend to specifying where most of the cuts will fall. The Liberal Democrats, who say they would not renew the Trident nuclear-missile system, have been franker about the need to axe major programmes. But something tectonic has shifted. The party ahead in the polls is promising cuts. The spell, and the consensus, are broken.

Like there's no tomorrow

The opinion polls provide both the opportunity and the motive for the Tories' move. It is predicated on quiet confidence about a general-election win next year—and a belief that, to limit the anger aroused by a subsequent downsizing of the state, a Tory government needs an explicit mandate for it. (Some senior Tories prophesy that theirs will be the most unpopular administration in history after six months.) But the Tories also think that cuts, and honesty about them, are ideas whose time has finally come.

The evidence for that conviction is mixed. Many voters tell pollsters that higher taxes are not the way to fix Britain's deficit—but neither are spending cuts. They think public services should be better funded—but also that much of the cash poured into them has been wasted. There has, however, been a marked decline in the salience of health and education (the two main public services) as political issues; jobs and the economy are now top. In short, Britons may not have become, suddenly, a race of zealous state-shrinkers; but, because of the downturn and doubts about the efficacy of New Labour's decade-long splurge, they are not as allergic to cuts as they once were. So proposing cuts may hurt the Tories less in the next election than in previous ones.

For their part, some of Gordon Brown's colleagues know the game is up. Some talk sheepishly about "efficiencies". Alistair Darling, the chancellor of the exchequer, refuses to be drawn about future spending allocations. Yet the prime minister himself seems trapped by his view of national psychology, apparently reinforced by his reading of the crisis as a left-wing moment, in which voters have an infinite yearning for spending rises (if not for commensurate tax hikes). He and some of his acolytes are imprisoned also, perhaps, by a notion of themselves as guardians of the public realm, a part of their political identities too vital to be revised. So they perform absurd statistical gymnastics to avoid admitting the squeeze that is inevitable. And Mr Brown bellows time-warped incantations about "how many doctors, how many teachers" the Tories would massacre.

In fact Labour might do better to fight on Mr Cameron's ground: yes, there must be cuts, it could argue, but only we can be trusted to make them humanely. That stance would help dispel the government's reputation for profligacy, while chiming with a residual hunch that the party cares more about the public services than the Tories. For Mr Brown, that might be too humiliating and disorienting a reversal; but if he can't manage it, his successor as Labour leader will probably have to. When that happens, British politics will have a new consensus—and it will be the opposite of the one New Labour intended.

Economist.com/blogs/bagehot

BRICs, emerging markets and the world economy

Not just straw men

Jun 18th 2009
From The Economist print edition

The biggest emerging economies are rebounding, even without recovery in the West

EPA

THE inaugural summit of the BRICs—Brazil, Russia, India, China—came and went in Yekaterinburg this week with more rhetoric than substance. Although Russia's president, Dmitry Medvedev, called it "the epicentre of world politics", this disparate quartet signally failed to rival the Group of Eight industrial countries as a forum for economic discussion.

But that should be no surprise: to realise how disparate they are, consider that Russia and Brazil are big commodity exporters, whereas China is a big commodity importer; China is a proponent of the Doha trade round, India a sceptic; India and China vie for influence in the Indian Ocean, Russia and China compete in Central Asia.

Instead, the really striking thing is that four countries first lumped together as a group by the chief economist of Goldman Sachs chose to convene at all, and in such a high-profile way. And that when they met, they discussed topics such as reforming the IMF; their demand for more say in global policy-making; and, in the case of China, Brazil and Russia, a plan to switch some of their foreign-currency reserves out of dollars and into IMF bonds.

All this reflects growing self-confidence. The largest emerging markets are recovering fast and starting to think the recession may mark another milestone in a worldwide shift of economic power away from the West. Estimates for their national incomes in the first quarter were better than expected. In the year to the end of March GDP rose by around 6% in China and India. The two accounted for no less than half the world's increase in wireless-technology subscriptions in that period. In Brazil gdp fell slightly in the first quarter but it is growing faster than the Latin American average and most economists think growth will return to its pre-crisis level as early as next year. In contrast, output in most large industrial economies is still falling. The exception in the BRICs is the host: dragged down by plunging oil prices last year, Russia's economy shrank by 9.5% in the first quarter, the worst performance in the G20 after Japan.

The fortunes of the others mark a sharp rebound since the turn of the year. Then, it seemed, the largest emerging markets faced being overwhelmed along with everyone else. Chinese exports in January were 18% lower than they had been a year earlier. Industrial growth fell by two-thirds in November and

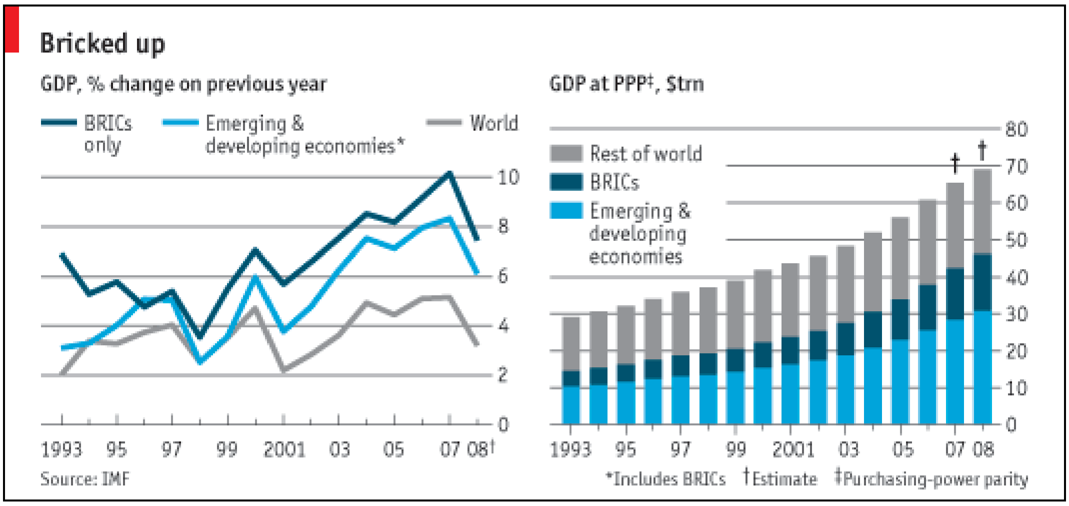
December. And around 20m migrant workers were wending their way back to their villages, jobless after the collapse of construction and export booms in coastal cities. The notion of “decoupling”—that emerging markets were no longer mere moons revolving around planet West—suffered a severe setback.

So what should one make of the turnaround? Might there be something to decoupling after all? Why are the BRICs recovering? And what are the implications for the rest of the world?

Decoupling means not simply that emerging markets tend to grow faster than rich industrial ones, although that is certainly true; it also implies that to some extent the two groups dance to different tunes, with emerging markets growing or shrinking autonomously, not just under the influence of rich ones. A study last year by Ayhan Kose of the IMF, Christopher Otrok of the University of Virginia and Eswar Prasad of Cornell University gave some support to this idea.

You would expect less decoupling as a result of globalisation. The cycles of output, consumption and investment should become more closely aligned in countries engaged in world trade. Yet when the authors looked at these indicators, they found something different. The cycles of output, consumption and investment did indeed become more closely aligned in rich countries. And the same thing happened in emerging markets. But when the authors compared the two groups, they found they were diverging. The business cycles of America and Europe converged. The business cycles of India and China converged. The business cycles of rich and emerging markets had decoupled.

When this study came out in mid-2008 the worldwide crash seemed to render it instantly obsolete. Yet the sheer size of the meltdown may temporarily have swamped deeper trends that are now reasserting themselves as the initial shock recedes. In 2000 developing countries accounted for 37% of world output (at purchasing power parities). Last year their share rose to 45%. The share of the BRICs leapt from 16% to 22%, a sharp rise in such a short period. Almost 60% of all the increase in world output that occurred in 2000-08 happened in developing countries; half of it took place in the BRICs alone (see chart).



If this pattern of growth were resuming, it would be good news: nearly half the world economy would be bouncing back. And there are one or two signs that the benefits of growth in the BRICs are being felt farther afield. Anecdotal evidence suggests “south-south” trade and investment by richer emerging markets in poorer ones continued to rise even as global capital and trade flows fell. One example of this is the “land grab” in which China and Gulf countries are buying millions of acres of farmland in Africa and South-East Asia. China overtook America to become Brazil’s largest export market in March and April; it is also now the largest exporter to India. China is using its $2 trillion of foreign reserves to invest in other emerging markets: for example, putting $10 billion into Petrobras, Brazil’s state-run oil company.

China’s appetite for raw materials to fuel resurgent growth probably explains the 36% rise in industrial raw-material prices since the start of this year, benefiting exporters of things like copper—though how long this will last is an open question. If it comes from the boom in Chinese investment spending, then the boom could continue. If China is merely filling its stores temporarily after a period of destocking, then prices could fall again.

But the resilience of China, India and Brazil cannot offset the dire state of the rest of the world economy. While the three giants recover, developing countries as a whole are mired in recession. The giants seem to

be decoupling not only from the West but from many of their smaller emerging brethren, too.

A series of reports confirms how badly things are going there. A review of ten poor countries by the Overseas Development Institute, a think-tank in London, concludes that they were worse hit than anyone expected, with sharp declines in remittances, employment and revenues and widespread balance-of-payments problems. As the study's author, Dirk Willem te Velde, points out, the differences are often striking. In some countries—Indonesia, Kenya, Bangladesh—foreign direct investment has held up reasonably well; others—Ghana, Nigeria and Zambia—are facing sharp declines. Cambodian textile exports have been hit harder than Bangladeshi ones. But because import demand, capital flows and the need for foreign workers declined precipitously in the West, almost all developing countries are suffering.

In its most recent assessment, the United Nations says at least 60 poor and emerging markets will this year suffer falls in income per person. The UN's forecasts for eastern Europe and sub-Saharan Africa are especially dark. For eastern Europe, Russia and its neighbours, the body predicts a fall in output of 5%. Arvind Subramanian, an economist at the Peterson Institute for International Economics, a think-tank in Washington, DC, argues that the recession in eastern Europe sounds the death knell for one of the two main growth strategies of the past 20 years—capital-account liberalisation (growth through exports is the other). The east European countries threw their financial sectors open to the world. In 11 of the region's countries, foreign banks account for over 60% of bank assets. The flood of foreign-currency borrowing destabilised their economies and left them vulnerable when Western banks reduced lending.

In Africa, the UN predicts, output will now fall by 0.9%. That might not sound too bad but only two months ago the IMF was forecasting a rise of 1.7% and at the start of the year the UN had projected a 4.8% increase. To return to pre-crisis growth, says the African Development Bank (AFDB), would require the continent to attract $50 billion of new money this year. Africa is nowhere near those levels because world capital flows are falling. The latest forecast by the Institute of International Finance says total net flows will collapse from $890 billion in 2007 to just $141 billion this year.

The AFDB fears that "a growth crisis" may be turning into a "development crisis", leading to sharp increases in poverty and malnutrition. By the end of 2009, says the UN, there will be between 105m and 143m more people in poverty than if growth had continued at its pre-crisis levels (see article). The main exception is in smaller East Asian countries, where industrial output is rebounding and GDP growth is likely to resume in the second quarter.

At the moment, then, recovery in the BRICs is coinciding with recession in the developing world as a whole. If this does not point to any change in global economic conditions, what does it reflect?

Partly, that the BRICs depend less on exports than do many emerging markets. In Brazil and India exports are less than 15% of GDP. China, too, exports less than many people think. Though exports were 34% of GDP in 2008, these included "processing exports"—goods imported into China, processed and exported without much value having been added. All three were thus less affected by the slowdown in world trade than most.

The BRICs were cautious in liberalising their financial systems, so have been less affected than, say, eastern Europe, by the West's financial heart attack. And their recoveries have been boosted by governments which have dramatically loosened monetary policy and increased government spending. But many other countries are relatively closed to trade and finance. Smaller ones like Chile and Taiwan have had a large fiscal stimulus. But few have done so well. Something more is needed to explain the recovery of the giants. A plausible explanation is size.

Size matters when world trade is falling because large economies have millions of domestic consumers to turn to when foreign markets fail. China is the best example. Small economies need trade to specialise, but the pressure of selling into a big domestic market helps companies in large economies remain competitive even without a lot of competition from imports. Big economies also tend to be diversified. India, for example, exports not just garments and cheap electronics—characteristic of many countries with similar levels of income per head—but ships, petrochemicals, steel and business services. Being diversified means little when markets all fail at once. But it is a big advantage when recovery begins since you are more likely to be in a business in which demand is rising.

Size and variety may also help the economic stimulus programmes of China, India and Brazil. In general, one of the commonest problems of government reflation is that the benefits leak out beyond your borders because the programme sucks in imports. Giant economies do not face this problem so acutely because

even when trade has been liberalised, imports naturally tend to be a lower share of GDP.

The other challenge is to ensure that government stimulus programmes are broadly based. This could be more difficult in small economies which specialise in relatively fewer sectors. A handful of big companies may be able to use political clout to grab the benefits of spending for themselves. In principle, giant countries such as India or China have more companies competing to manipulate the government for a share of the spoils. That is speculation, but the fact is that the stimulus programmes in the big emerging markets have been, mostly, large and effective.

China's stimulus package was the earliest and best-known example of fiscal shock and awe. But it is only part of the story. The government is using the state-owned banks to pump out loans at astonishing rates. According to Josh Felman, of the IMF's Asia research department, state banks and others issued 5.5 trillion yuan ($800 billion) of new loans in the first quarter—more than in the whole of 2008. This is producing a spending splurge on steroids. Excluding SUVs, almost as many cars are being sold in China as in America. In 2006 Americans bought twice as many.

Brazil and India are following suit, albeit more modestly. Brazil reduced reserve requirements and gave banks and its deposit-insurance fund incentives to buy up the loan portfolios of smaller banks. These measures injected 135 billion reais ($69 billion) into the domestic credit markets, according to Otaviano Canuto of the World Bank. Domestic credit rose sharply between September 2008 and January 2009 and consumer confidence is rebounding.

The source of India's resilience, argues Mr Subramanian, was "goldilocks globalisation": neither too dependent on foreign capital, like eastern Europe, nor too reliant on foreign customers, like parts of East Asia. Foreign capital dried up in the crisis, so India relied on domestic savings, which amounted to almost 38% of GDP in the year to March 2008. Companies thus turned for loans to India's unfashionable state banks, which hold almost 70% of bank assets, rather than borrowing overseas or raising money on the stockmarket.

India's growth was also shored up by government outlays, such as a generous pay rise for state employees, the cancellation of small farmers' debts, and the expansion of its rural-workfare scheme. Announced before the crisis struck, this spending was fortuitous. It left the public finances deep in the red, even as it helped the government to a decisive election victory. So far, this political triumph has boosted confidence in India more than the budget deficit has dampened it.

State of triumph

The question is whether such splurges are efficient and how long can they last. Consider China's investment (see article). According to the IMF's Mr Felman, in early 2008 all the contribution of investment to growth came from non-state-owned enterprises, mostly the private sector; since December 2008, more than half has come from state-owned enterprises. Something similar is happening in Brazil. Between last September and this January credit from foreign-owned and domestic private banks rose by 3%; credit from public banks rose by 14%. The beneficiaries seem to be large firms, where loans are growing four times as quickly as at small ones.

It is not clear how far, in the long run, the BRICs will be affected by a big rise in the size of the government and large state-owned firms. But that rise is probably inevitable. China and, to a lesser extent, Brazil and India, benefited hugely from America's appetite for imports in 2000-08. That appetite has fallen and is likely to remain low for years, as American consumers adjust their spending and savings habits. The rise may also be difficult to reverse: the experience of the West has been that the public sector expands relentlessly until it reaches between 40% and 50% of GDP. But if the BRICs cannot export their way out of recession, the expansion of government is the main alternative to the slump being endured in those other big capital exporters, Germany and Japan. It is part of the price China and others are paying to clamber out of recession before everyone else.

The poor and the global crisis

The trail of disaster

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From The Economist print edition

The downturn is claiming victims that never appear on a balance sheet

Eyevine

A long walk from the boardroom

NINE months after the collapse of Lehman Brothers, the world's economic crisis is still usually discussed as though it consisted of dire bank balance-sheets, falling exports and bankruptcies or job losses in the West. But at the other end of the trail that starts with financial woes in rich countries are underweight children and anaemic expectant mothers in poor ones. New research by the United Nations' standing committee on nutrition (available on www.unscn.org) gives a first estimate of how the crisis has hurt the group of people most affected by the crash: the very poorest.

In 1990-2007, the number of hungry people rose by about 80m, though this was, by and large, a period of rising incomes in developing countries (and a huge increase in population). In 2008 alone, the number rose a further 40m, to 963m—half as much in one year as during the previous 17. In other words, lots more children and pregnant women are not getting the food they need. The report reckons that the number of underweight children will rise from 121m to 125m by 2010, assuming no change in the size of the world economy (in fact, it is expected to shrink 2% this year). The World Bank has already estimated that until 2015 the crisis will lead to between 200,000 and 400,000 more children dying every year.

The poorest face two crises: the world recession and the resumption of food-price rises. Food prices had been falling but even then, the global price fall did not translate into a comparable decline on local markets in most poor countries, so the poor did not benefit much. World prices bottomed out in December 2008 and have since risen 26%. In the poorest countries, a rise of 50% in the price of staples pushes up the family food budget from 50% to 60% of household income.

Initially, people skimp on non-staple foods, cutting the quality and diversity of their intake; in the next stage, the quantity and safety of diets suffer. That in turn damages their health. Currently, around 50m, or 40%, of pregnant women in developing countries are anaemic. Anaemia in expectant mothers, which causes low birth weight and unhealthier babies, is likely to rise by a further 1.2m in Asia and 700,000 in Africa.

To make matters worse, this is happening at a time when the global slump is causing job losses or wage squeezes everywhere—worldwide unemployment rose to 6% in 2008—so in some poor countries, it now takes an extra ten hours a week or more to feed a family of five.

The resulting burden falls heavily on women. As the report says starkly: "Women are usually the last to benefit from increasing income [but] they are usually the first to make sacrifices when the financial situation deteriorates."

Corporate restructuring in Japan

Breaking free

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From The Economist print edition

Japanese firms are responding quickly to the recession, but are they doing enough?

Illustration by Claudio Munoz

IN RECENT months Toyota has replaced its bosses, halted pet projects and temporarily cut production in Japan almost in half. Toshiba took control of affiliates and said it would shut down unprofitable businesses. Sony plans to halve the number of its suppliers to save {Yen}500 billion ($5.2 billion) this year alone. All have cut back their part-time and temporary workers, who had only ever been promised a pay-cheque, not a job for life. The actions of these prominent Japanese companies have encouraged others to follow suit.

During the "lost decade" of 1991-2002 Japanese firms dithered rather than adopting the harsh measures that might have prevented a drawn-out stagnation. But this time around the response has been much faster and deeper. After all, if any country ought to know how to respond to a low- or no-growth environment it is Japan: it has had plenty of practice.

The press has done its part, continually reminding the public of the "once in a century" nature of the crisis and thus providing support for the lay-offs. And banks have played a more constructive role than they did in the 1990s, by refusing to extend credit to some needy firms that cannot meet their obligations—to the dismay of politicians and bureaucrats.

It helps that unlike during the bursting of the country's bubble economy in 1991, the crisis originated outside Japan and all unpleasant measures could be blamed on the American bankers whom many Japanese held responsible for it. And the sudden collapse of export sales, which happened in tandem with a spike in commodity prices and an appreciation of the yen (which makes Japan's exports more expensive), meant that corporate Japan had no choice but to act.

All this is quite a turnaround. During the lost decade Japan regarded its problems as a private, domestic matter: it resented outside pressure to sort out errant banks, speculative property developers, overly ambitious conglomerates and so on. Corporate reforms were introduced, albeit slowly and imperfectly. Jobs, sacrosanct in Japan, were eventually shed. The reaction this time is notable because it capitalises on the changes introduced back then and provides an opportunity to push for even more restructuring.

It is sorely needed. The drop-off in demand from the West has clobbered Japan's export economy. Foreign trade is down one-third. Japan's economy is expected to contract by 6% this year, making it the worst-hit among rich countries. Industrial overcapacity is thought to be much higher than in America or Europe. Indeed, things are so bad that it is generally assumed that they cannot get any worse, and will instead improve over the next six months as the inventory cycle turns and firms restock. This has helped push the Nikkei 225 share index up by around 40% since March, when it hit a 26-year-low.

Many firms failed to restructure seriously during the lost decade, especially after 2002 when record profits poured in from exports. Companies refused to pare their sprawling operations and spin off non-core units (it is common for firms to own their own hot-spring resorts, for instance). But the recession has strengthened the hand of reformers.

The most widespread form of restructuring is the easiest: cutting staff. Since the lost decade, Japan's labour force has become more flexible, as the post-war tradition of lifetime employment has waned. "Non-regular" workers, as temps and part-timers are known, have increased from one-fifth to one-third of the workforce. Labour represents around 70% of Japanese business costs: though hard on individuals who are sacked, the rise of non-regular workers has let firms cut costs fast.

It is still difficult and expensive to lay off "regular" workers. Firms typically provide the main pensions of staff they jettison, as well as lump-sum severance packages. This explains why companies such as Toshiba must raise huge sums to cover restructuring costs.

Another sign of change is corporate Japan's sudden zeal for mergers and acquisitions, despite the uncertain business environment and a scarcity of capital. Last year Japanese firms spent a record amount acquiring businesses abroad, and the buying has not abated. Firms such as Kirin, a beverage-maker, J-Power, an electricity wholesaler, and many others have bought foreign companies this year. Japan's stagnant domestic economy offers no prospects for growth, and the strong yen, low asset prices and a dearth of rival bidders make it a good time to pounce.

But most transactions were domestic, as companies span off units or took direct control of affiliates. In recent months Hitachi, Toshiba and Fujitsu, among others, have shuffled their businesses in ways that were unthinkable before the downturn. In the first quarter of this year dealmaking in Japan even exceeded that in China, with a total value of $30 billion.

But is the restructuring going far enough? The emphasis has been on cost-cutting, rather than overhauling business models. And most of the big moves have been made by Japan's big export-focused firms, which were the first to be affected by the downturn. There has been much less reform among Japan's huge swathe of inefficient, domestically oriented companies.

Moreover, even those firms that are trying to cut costs have tried to spread the pain among their suppliers, which may actually make things worse in the long run. The advantage of commercial camaraderie is that firms can count on at least a little business to keep them alive. But propping up ailing ones ultimately harms their healthier rivals, by depriving them of resources they could more fruitfully deploy, including capital and qualified staff.

An executive at a medium-sized supplier to a big electronics firm explains how. The electronics firm continues to do business with weak suppliers offering inferior technology, depressing prices and profits for stronger ones. This has forced him to cut his research budget. "How can we keep up with the technology cycles if we lack the profits to invest?" he asks.

Saving jobs in Europe

Pain and pleasure

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Work with no pay for some workers and pay with no work for others

AFP

These days he's gardening

NEXT month the shareholders of British Airways will enjoy the services of the firm's embattled boss and finance chief, free of charge, as the pair do their bit to cut costs by foregoing a month's wages. This week the firm urged other employees to volunteer to work without pay for a spell as well, since the airline is in a "fight for survival". To soften the blow, it has generously offered to spread out the loss of earnings over several months.

Marcegaglia, a big Italian steel firm, has been a little bit more imaginative in its bid to protect jobs. Since February, the 4,500 workers at its 27 Italian factories have been enjoying more time off than usual, since the firm does not have enough work to keep them busy. But they will not lose any pay. Luigi Dedei, a trade union official who helped negotiate this agreement, says that many are from farming families or have vegetable plots and have been using their new-found leisure time to tend their crops.

Production of metal products in Italy dropped by 11.9% in the fourth quarter of last year and by a further 31.7% in the first quarter of this year. Marcegaglia turns steel coils into the tubes, strips, bars and plates needed in an enormous range of goods. Its production has fallen this year by between 25% and 30%, depending on the product. The scheme allows the firm to avoid laying off skilled workers who would be hard to replace when the economy recovers. It also avoids the pay cuts that workers would suffer if Marcegaglia entrusted them to a national fund that pays reduced wages to those who would otherwise be laid off.

Antonio Marcegaglia, the group's managing director, admits that not all firms can afford such schemes, especially if the downturn is protracted. But there is something in it for the owners: workers have promised to repay the firm for the holidays taken but not yet earned by working overtime when the economy picks up. (Overtime accounted for about 5% of hours worked before the recession hit.) Mr Marcegaglia is confident that the group's output will return to the record level of 2008 next year, so the scheme may be short-lived. Meanwhile, says Mr Dedei, workers whose night shifts have been eliminated are probably taking their time off in bed.

Economist.com BUSINESS

America's thriving gossip magazines

Rags to riches

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From The Economist print edition

One corner of the print-news industry is relatively healthy

FOR seven of the past eight weeks the front cover of *Us Weekly* magazine has featured salacious stories about Jon and Kate Gosselin. The Gosselins, who have eight children including sextuplets, are the stars of an obscure American reality-TV programme that briefly became the most watched show on cable. Sensing a surge of interest, other celebrity magazines have piled in with reports of marital disharmony. Even in a recession, tittle-tattle sells.

Buoyed by recession-resistant food, pharmaceutical and shampoo advertisements, gossip magazines have lost fewer advertising pages in the past year than business or news magazines, according to a tally by *Mediaweek*. The two biggest, *People* and *Us Weekly*, each sold more copies last year than they did in 2001. In a world of fragmenting audiences they boast an enormous reach. Fully 43m Americans, about two-thirds of them women, flick through a copy of *People* each week.

This is odd, because the forces blamed for the decline of print news are no less potent in the celebrity sector. Celebrity news has its own online aggregators, several of them linked to web portals, such as omg!, the gossip arm of Yahoo!. The self-publicising Perez Hilton leads a legion of bloggers. Tweets, mobile-phone alerts and gossipy television shows (there are five, up from three in 2000) provide much more timely information about the lives of the beautiful than do magazines. There is more direct competition, too, with three big glossy magazines having launched since 2002.

It may be that the new entrants have simply mopped up excess interest in the doings of Paris Hilton and Lindsay Lohan. Larry Hackett, the editor of *People*, reckons that the public appetite for entertainment news was underserved until recently. Far from harming the established publications, the multimedia gossip barrage may be driving readers to check scurrilous rumours with them.

The field is probably too crowded. None of the three new publications—*In Touch*, *Life & Style* and *OK!*—sold more than a million copies a week on average last year. The turbulent economy has shaken lucrative news-stand sales in particular. As the weaker publications struggle, though, the strongest ones are expanding boldly into new platforms and products. *People* has launched an iPhone application and its website receives 13m unique visitors per month, according to comScore, a research firm. Its empire includes a fashion portal, a Spanish-language magazine, a country issue, puzzle books and a pets website, all written in the same reassuring style.

However far-flung their operations, celebrity publishers know they must drive traffic to the weekly magazine, where the real money is still to be made. The best websites offer titbits, updates and quotes. When it comes to longer articles and scoops, though, online readers are firmly steered to the news-stand with notes that begin, “To find out more…”. Janice Min, the editor-in-chief of *Us Weekly*, reckons the content of her magazine and its associated website overlap by no more than 15%. “Why would you post your entire cover story online?” she asks.

Airbus and Boeing resume their feud

Hard pounding

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Orders may be down, but the giants of aviation are still at each other's throats

EPA

Look! A customer

DISTANT indeed seem the days when the two great rivals of commercial aviation, Boeing and Airbus, would use big air shows to trumpet hundreds of new orders. This week's biennial show in Paris was a much more sombre affair, even if the Boeing-Airbus feud still took centre stage.

There were one or two bright spots. Airbus was able to boast of a firm order for ten of its wide-body A350s from AirAsia X. John Leahy, its top salesman, expects deliveries in 2009 to match last year's record 483. Boeing, which was hit by a prolonged strike in 2008, will probably deliver more aircraft this year than last. Both firms built up huge backlogs in the fat years: each has orders for about 3,500 planes.

But many of those may soon evaporate. Giovanni Bisignani, the boss of IATA, the trade body that speaks for most airlines, gave warning earlier this month that his members might defer as many as 30% of aircraft deliveries next year. He also almost doubled his forecast for the industry's cumulative losses in 2009, to $9 billion.

Both Mr Leahy and Jim McNerney, the chief executive of Boeing, think that Mr Bisignani is overdoing the gloom. But they concede that potential customers may find purchases hard to finance. A case in point is America's United Airlines, which has asked Boeing and Airbus to bid for an order of 150 aircraft. Mr Leahy says helping United drum up loans will be the key to winning the order. Another issue is the cost of fuel. Mr McNerney thinks the recent increase in the oil price should encourage carriers to replace elderly gas guzzlers with efficient new planes. But if the price "spikes over $100" all bets are off.

The two aviation giants agree on one other thing: the industry will not get a successor to its ubiquitous short-haul workhorses, the 737 and the A320, for more than a decade. That is partly because the 15-20% efficiency gain that airlines say they want from the next generation is, says Mr McNerney, "a bar that keeps moving north" thanks to the continuous improvements of 1-2% a year that the manufacturers are making to existing planes.

Moreover, both Boeing and Airbus are conserving cash for a long and bitter scrap to dominate the market for long-haul aircraft with up to 350 seats. Boeing's troubled 787 Dreamliner will at last take to the air this month, two years late. Mr McNerney says it will be "a moment of euphoria", especially for those engineers who have not had a holiday for three years. The production problems that stemmed from both the revolutionary use of composites and an extended global supply chain appear to have been overcome. To speed up deliveries of the 787, for which Boeing has received more than 860 orders, Mr McNerney is planning a second assembly line.

The delays to the 787 have been a godsend for Airbus. Its rival, the slightly bigger A350, is on track to fly in early 2012 after a painful gestation. With nearly 500 orders, Airbus claims that the A350 is selling even faster than the record-breaking 787 did at the same stage in its development. The biggest concern for Boeing, however, is not that the A350 will take sales from the 787, but that its largest variant, the A350-1000, will be a strong rival to its successful 777. Mr McNerney says that Boeing can afford to wait and see how great a threat the biggest A350 is: "We have time to react, to find out what it is and what it isn't." But according to Airbus executives, Boeing will be faced with the dilemma of merely upgrading the 777 or taking the bigger and more costly step of building a replacement.

The A350 and the 787 are at the heart of the long-running and acrimonious dispute between Boeing and Airbus at the World Trade Organisation (WTO) over state subsidies for large commercial aircraft. This week

European governments declared that they were ready to contribute €3.5 billion ($4.9 billion) of reimbursable launch aid to the €11 billion cost of developing the A350. The announcement had Boeing executives scurrying to their BlackBerrys to condemn what they saw as a “provocative” move given that the WTO is expected to issue a ruling on Boeing’s complaint within weeks (a ruling on a counter-complaint by Airbus is due later in the year).

Louis Gallois, the chief executive of EADS, the parent company of Airbus, denied there was anything odd about the timing: “We do not plead guilty,” he said. “Our support is much more transparent than Boeing’s. We have fully repaid with interest the support we received for the A320 and A330 and we are already paying back on the A380 [super-jumbo].” Tom Enders, the chief executive of Airbus, added that the aid was aimed only at “levelling the playing field” and that the European Union had described the 787 as the most subsidised commercial aircraft in history.

Another bitter battle between the two companies is about to resume. Within the next month or two, the United States Air Force will ask Boeing and Airbus (with its American partner, Northrop Grumman) to rebid for the $35 billion contract to replace its fleet of ageing aerial tankers. Airbus won the deal last year, only to have the decision overturned after a protest by Boeing. It fears that this time the dice may be weighted against its more costly but “better value” A330-based tanker in favour of Boeing’s smaller 767 derivative. For its part, Boeing says that, if the Air Force really wants a bigger plane, it will offer the 777. An order split between the two competitors is a possible compromise—one that many of the world’s airlines, which benefit greatly from playing one firm off against the other, might sympathise with.

The Saad and Algosaibi groups

Family fortunes

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The obscure origins of a crisis at a Saudi conglomerate

IN DECEMBER *Arabian Business* magazine published its annual ranking of the richest Arab businessmen. Third on the list was Maan al-Sanea, with a fortune of $9.3 billion. Born in Kuwait, where he trained as an air-force pilot, Mr Sanea now heads the Saad group, an investment company based in Saudi Arabia. By the end of last year the group's assets exceeded $30 billion, including $7.1 billion in cash and $10 billion in liquid securities. Its credit rating was investment grade. Mr Sanea is not, then, a man who should have trouble getting money out of the bank.

But on May 28th the Saudi Arabian Monetary Agency (SAMA), the country's central bank, froze his bank accounts. It gave no reason for its action. In a country that prizes reputation and discretion above all, things like that do not normally happen to people like him.

The Saad group says that its business accounts are "unimpaired". Nonetheless, creditors have run for the exits. On June 2nd the Saad Group's credit rating was cut, then withdrawn. On June 7th banks in the United Arab Emirates were instructed not to lend more money to Mr Sanea or one of his businesses. The Saad Group has admitted it is facing a "liquidity squeeze". To raise cash, it has been selling its holdings all over the world, including shares in HSBC, in which it was the second-biggest shareholder; Berkeley, a British homebuilder; and 3i, a private-equity firm. It blames "events specifically affecting the Bahraini banking sector" and "the failure of companies owned by a prominent Saudi family business" for its misfortunes.

The prominent Saudi family is undoubtedly the Gosaibi clan, which owns Ahmad Hamad Algosaibi & Brothers (AHAG), another powerful conglomerate—but little else about the story is clear. A venerable merchant dynasty, ranked 19th in *Arabian Business*'s list, the Gosaibis made a fortune from the pearling industry, then found new momentum in the 1950s filling Pepsi bottles. But since the death earlier this year of its chairman, Sulaiman al-Gosaibi, the group has suffered a reversal. In May a Bahraini bank owned by AHAG defaulted on some of its obligations. On June 11th AHAG said it had found "strong evidence" of "substantial financial irregularities" in its financial-services arm.

When the Saad Group puts its misfortunes down to a "private family dispute", it seems to be suggesting that it has somehow mistakenly got caught up in AHAG's troubles. Mr Sanea's wife is Mr Gosaibi's niece. He has long-standing personal ties to the clan and used to be a managing director of AHAG. But the Saad Group insists that neither group has any stake in the other, and that any business ties between them are now at "arm's length".

If the problems that prompted Sama to freeze Mr Sanea's personal accounts did indeed relate to AHAG, and not to Saad Group, then the Saudi authorities have inadvertently sparked a run on one of their biggest conglomerates. But it is impossible to be sure without more information.

Ironically enough, the Saad Group lists "family values" as a cornerstone of its investment philosophy. Yet in some ways it was seen as an example of the apparent evolution of the Gulf's family conglomerates. It had earned itself an investment-grade rating, steered clear of flashy purchases and hired outside professionals, including a former chairman of Barclays bank, to oversee its investments. Unfortunately its present difficulties are a stark example of the attributes that are holding Saudi capitalism back. Local firms depend heavily on the patronage of wealthy families, whose connections to each other and to the authorities are hard to fathom, yet impossible to ignore.

General Motors sells Saab

Unstable atom

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Does the troubled Swedish firm have a future?

AFP

Koenigsegg attempts fusion

THE fact that bankrupt General Motors appears to have flogged three of its unwanted brands—Saturn to a car dealer, Hummer to a Chinese maker of heavy-duty trucks and now Saab to a tiny sports car company—lends substance to the idea that there's one born every minute. The buyers may not be paying much, but at a time when the car industry should be consolidating rather than atomising, they are taking on an awful lot of risk.

Of the three, only the fate of Saab will be of any concern to car lovers: Saturns were sold to people who were looking for smiley-faced service rather than a good drive; Hummers were bought by men who were insecure about their masculinity and by Arnold Schwarzenegger. But Saabs, with their rally-winning heritage and powerful turbo-charged engines, appealed to discerning buyers who valued understated Swedish design and innovative technology.

Sadly, under GM those qualities were steadily diluted in an ill-judged attempt to stanch the losses that Saab made in all but one of the American firm's 20 years of stewardship. Short-sighted cost-cutting and the imposition of stodgy GM engineering resulted in Saabs that were no longer special. As the onslaught from German premium carmakers, especially BMW and Audi, intensified in the 1990s, Saab ended up in the uncomfortable position of making around 120,000 not-quite-premium cars a year.

At least Koenigsegg, the Swedish supercar-maker that this week signed a memorandum of understanding to acquire Saab from GM, is run by people who should understand the unique quirkiness of Saab's appeal. That apart, Saab has little in common with a firm that makes fewer than 20 cars a year, at a price of more than $1.2m apiece, and has a workforce of 45—about 1% of Saab's.

Koenigsegg, named after its founder Christian von Koenigsegg (pictured), a former whizz-kid financier, will get a $600m loan from the European Investment Bank guaranteed by the Swedish government, and a dowry from GM in the form of platforms, powertrains and about $500m in cash and other assets. To succeed, Koenigsegg must find a profitable niche for Saab that will generate around 50,000 more sales each year than the 93,000 cars sold in 2008. Not impossible, but a pretty tall order.

Corporate hedging gets harder

The perils of prudence

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The credit crunch has made it much more difficult and expensive for firms to hedge their risks

WARREN BUFFETT, one of the world's most famous investors, once called derivatives "financial weapons of mass destruction". Central bankers worry that those sold "over the counter", meaning outside exchanges, threaten the stability of the whole financial system. Yet firms that rely on derivatives to limit their exposure to swings in commodity prices, interest rates or exchange rates cannot get enough of them—literally.

Several firms using derivatives in an attempt to manage such risks have suffered huge losses of late, on paper at any rate. Among the hardest hit have been airlines, many of which paid to protect themselves from higher fuel prices last year when the oil price peaked at $147 a barrel. Because oil now costs much less, many have had to write down the value of those contracts, even if they are not due to be settled for years. The losers included Cathay Pacific Airways, which made paper losses of close to $1 billion, Ryanair, Air France-KLM and Southwest.

Nonetheless, firms seem as keen to hedge as ever. According to a study by Greenwich Associates, a consultancy, big American, European and Asian firms hedged 55% of their exposure to fuels last year, up from 45% the year before. Even some of the airlines that posted large losses on derivatives tied to the oil price are buying more of them. Ryanair recently said that it has entered contracts to fix the price of 90% of its fuel for the first nine months of this year, almost twice the proportion it had hedged in January. Cathay Pacific, meanwhile, is buying instruments that will protect it from falling as well as rising fuel prices.

The main reason for this enthusiasm, says David Carter, an academic at Oklahoma State University and one of the authors of several papers studying fuel hedging in the airline industry, is that banks are normally more willing to lend to firms that have reduced their risks by hedging. That in turn allows them, for instance, to buy cheap assets from ailing rivals.

Far from suppressing firms' appetite for derivatives, the turmoil in the world's financial markets has increased it. Of the big corporations Greenwich surveyed last year, 38% used options to manage currency fluctuations, up from 28% a year earlier, and the volume of currency options they bought had increased by about a third. In general, the use of interest-rate and currency options has risen dramatically in recent years (see chart).

But in the second half of last year, such hedging declined for the first time since 2001, according to the International Swaps and Derivatives Association, an industry group. Thanks largely to the credit crunch, banks are selling fewer derivatives at a higher cost. Many firms, especially those with weaker credit ratings, have simply been frozen out of the market for derivatives by banks' reduced willingness to carry risk. Bankers say that only the few airlines with the highest credit ratings have been able to add to their hedge books in recent months to take advantage of lower oil prices.

The bankers' reluctance stems from the nature of hedging contracts which, although not officially loans, nonetheless create liabilities between banks and their customers which grow or shrink as the underlying variable changes. Thus many of the airlines that had hedged their fuel consumption when oil prices were higher built up huge notional debts to banks, even though no money was due to change hands until the contracts reached the end of their lives, by which time oil prices could have risen again. The amounts concerned can easily grow to exceed the internal limits that banks place on their exposure to particular clients or even industries, preventing them from extending additional credit or writing new contracts.

It is not just airlines that are affected. Indian textile exporters, for instance, complain that their banks are not allowing them to take on new currency hedges because of paper losses on contracts tied to the dollar. Pension funds are being affected too, mainly because some specialised derivatives, including certain types of hedges against inflation, completely dried up for a time last year.

Those hedges that are available have become much more expensive. That is partly because markets are less liquid and less competitive since the collapse of Lehman Brothers last September. But banks are also now explicitly charging for the credit risk that they assume when writing a derivative contract. Estimates of the additional cost that companies are paying to hedge risks vary from firm to firm and product to product, particularly as they depend on the creditworthiness of those who are buying them. But some in the industry talk of bank fees rising from less than 0.1% of the value of a deal to as much as 2%.

For many firms, such costs are prohibitive. The main victims are big exporters of manufactured goods. ThyssenKrupp, a German industrial firm, hedges its currency exposure each time it signs a large export order, for example. Similarly Rolls-Royce, a British aerospace company, is active on foreign-exchange markets because most of its revenues are in dollars but many of its costs are paid in pounds.

Ever since the collapse of Lehman Brothers last year, firms have been worrying about whether they will ever be able to collect on the hedging contracts they have bought if their bank collapses. John Grout of the Association of Corporate Treasurers, an industry group, says that some perfectly solvent banks have wriggled out of derivative contracts by invoking obscure break clauses that they had previously promised their customers they would never use.

Banks, meanwhile, fear that some of their cash-strapped customers may default. The result, says one banker involved in advising firms, is that many of them are asking firms to post collateral for the money they owe on derivative contracts. In effect many are edging towards the sorts of arrangements that regulators are thinking about imposing more broadly: moving most derivatives onto exchanges and having them centrally cleared.

Yet such arrangements, too, are deeply troubling for many big firms. By turning paper losses into real ones they represent, in effect, a massive withdrawal of credit. Timothy Murphy, the foreign-currency risk manager for 3M, a large manufacturing company, gave warning in testimony before a subcommittee of America’s Congress earlier this month that mandatory clearing of derivatives would “add significant capital requirements for end-users, adding significant costs, discouraging hedging, and diverting scarce capital”. The only thing more dangerous than having too many derivatives floating around the financial system, it seems, may be having too few of them.

Face value

Godly but ambitious

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Adnan Yousif wants to build the first truly global Islamic bank

Photoshot

MOST practitioners of Islamic finance pride themselves on their modesty. But not Adnan Yousif, the chairman of the Union of Arab Banks, a regional club for financial firms. He has recently struck a tone more reminiscent of greed-is-good Wall Street, with a grand plan to build the biggest Islamic bank yet seen, spanning the world and providing Muslim countries with new financial services their people have barely heard of. “People never thought big here, never thought globally,” he says.

Mr Yousif’s ambitions date to the founding of modern Islamic finance. During the 1970s oil boom the Gulf’s Muslim elite needed to put their new-found wealth somewhere, and American government bonds seemed the safest option. Yet Islam prohibits the charging of interest. So some sheikhs bought bonds but let their Western banks keep the interest, in the casual manner of a customer leaving change on a restaurant table. To Mr Yousif, then a young banker at American Express in his native Bahrain, this made no sense. At a time when Muslim countries had imposed an oil embargo over America’s support for Israel why, he wondered, refuse the Americans oil but give them billions of dollars?

The embargo faltered and ever more money flowed to the Gulf, prompting Muslim scholars to seek ways to cleanse finance of interest payments. Practical men like Mr Yousif paid attention. In 1980 he moved to Arab Banking Corporation, a Bahraini bank, and set up an Islamic-finance division. It was little more than a few desks in a bare room where white-robed bankers created investments that generated profits in forms other than interest. The bank’s bosses thought it would be, at best, a niche business with little chance of competing against Western-style finance.

But over the next two decades Islamic banking prospered, driven by a revival of faith following the Iranian revolution in 1979. By the turn of the century there were more than 200 Islamic banks and Mr Yousif was leading from the front. He turned his bank’s Islamic-finance division into a stand-alone institution, then became chief executive of Bahrain Islamic Bank in 2002. Two years later, now head of the Al Baraka Group,

another Bahraini bank, he oversaw its initial public offering (IPO), the largest thus far by an Islamic bank. Along the way, interest-avoidance schemes became ever more sophisticated. Today $700 billion of global assets are said to comply with *sharia* law. Even so, traditional finance houses rather than Islamic institutions continue to handle most Gulf oil money and other Muslim wealth.

In private, some Gulf bankers speak of the need for an “Islamic Goldman Sachs”. That is what Mr Yousif is now attempting to create—a *sharia*-compliant investment bank with global reach and ready access to capital. It will be called Istikhlaf, Arabic for “doing God’s work”. Others in the industry have welcomed the move. “Islamic banking cannot be taken seriously until we have some global Islamic banks,” says Simon Eedle, managing director of Islamic banking at Calyon, a French investment bank. “They don’t have to be present everywhere in the world, but they need to be in the top 100.”

Mr Yousif says he has raised $3.5 billion from Gulf investors and is seeking the same again by the end of the year. In addition he plans a $3 billion IPO in Dubai and Bahrain. The oil price is down from last year’s peak, but there is plenty of cash in the region looking for a home. So far, though, most of what Mr Yousif has collected comes from other banks rather than private investors. He and his backers, including Sheikh Saleh Kamel, the force behind the Al Baraka Group, delayed the launch of Istikhlaf last year after turbulence in the financial markets. They also dropped talk of raising up to $100 billion—at least for now.

Even with a more modest capital base of $10 billion, Istikhlaf will stand a reasonable chance of picking up lucrative finance deals. The region’s ubiquitous infrastructure projects need beefy backers. Most Islamic banks have so far been absent from this field because of their small size. Deals instead went to *sharia*-compliant units of multinationals like Deutsche Bank, HSBC and Citigroup. These will now face stronger local competition.

Mr Yousif’s ambitions do not end there. He plans to create a team of venture-capital researchers to sift through innovators’ ideas and provide the good ones with a cradle-to-IPO service. Many people do this successfully in Silicon Valley, but potential investors in his bank may wonder how easy it will be to transplant that sort of high-technology entrepreneurship to the Gulf.

You say sukuk, I say heresy

More worrying still, the rules for Islamic finance are not uniform around the world. A Kuwaiti Muslim cannot buy a Malaysian *sukuk* (*sharia*-compliant bond) because of differing definitions of what constitutes usury. Indeed, a respected Islamic jurist recently denounced most *sukuk* as godless. Nor are banking licences granted easily in most Muslim countries. That is why big Islamic banks are so weak. Often they are little more than loose collections of subsidiaries. They also lack home-grown talent: most senior staff are poached from multinationals.

There are worries, too, about Istikhlaf’s lack of a Saudi presence or partner. There have been rumours of a merger with Saudi Investment Bank, although Mr Yousif has denied this. Such a deal would be a big help. Saudi Arabia is one of the main growth areas for Islamic banking. It has the largest oil reserves and the most valuable project-finance deals. It is no coincidence therefore that the biggest Islamic bank to date, Al Rajhi, is Saudi. But if anyone can snatch the lead from the Saudis it is Mr Yousif. Never afraid of breaking the mould, he confesses to admiring Alan Greenspan, a man (of Jewish origins) better known as a disciple of Ayn Rand, the prophet of rugged capitalism, than as a scholar of holy scripture. Mr Yousif has read the former Fed chairman’s memoirs “three or four times”, he says. With luck he will heed Mr Greenspan’s warnings about irrational exuberance.

Economist.com OPINION

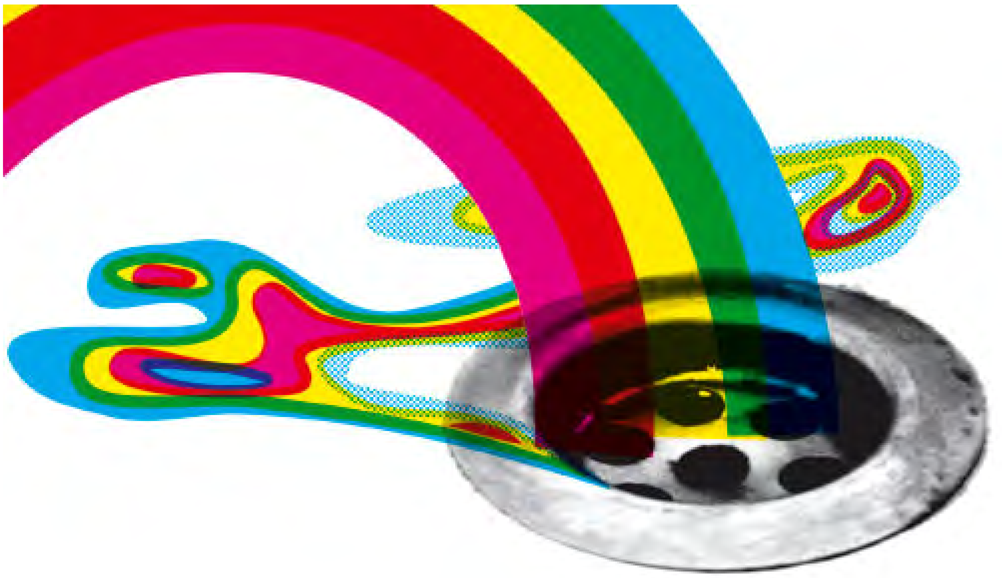
Fund management

Wasting assets

Jun 18th 2009
From The Economist print edition

Revenues have tumbled, profits have been squeezed and some owners are keen to sell. Fund management is set for a wave of mergers

Illustration by Otto Dettmer



BLACKROCK is on a roll. With the purchase of Barclays Global Investors (BGI), finalised on June 16th, a firm founded a mere 21 years ago has become the biggest asset manager in the world. The deal unites BlackRock's expertise in fixed income with BGI's renown in index tracking, notably through its retail arm, iShares.

The $13 billion purchase is the banner deal of the latest wave of restructuring in fund management. For much of the past 25 years the industry prospered as rising asset prices drove up its fees. But it took a terrible hit in 2008 as falling stockmarkets, an exodus of clients and scandals (in particular, the Bernie Madoff affair) combined to ruin its reputation. Around a third of assets and 40% of revenues have disappeared, according to Denis Bastin of Oliver Wyman, a consulting firm. Bob Doll, BlackRock's vice-chairman, has estimated that as many as half the world's asset managers are breaking even at best.

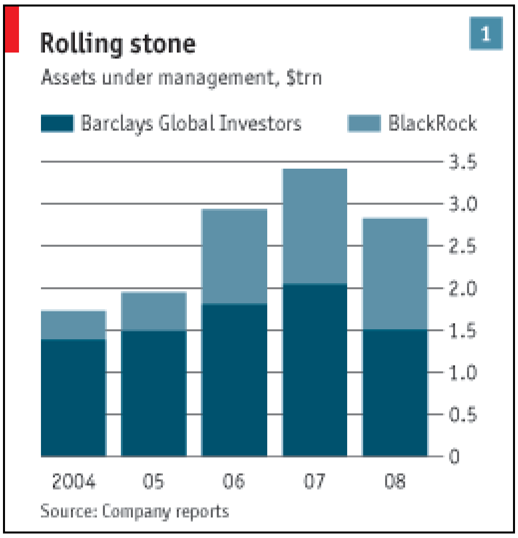
BGI is among the more successful ones. It is being sold mainly because its parent bank, which turned down funds from the British government, wants to bolster its capital base. Barclays is not the only bank retreating from fund management (though it is retaining a 19.9% stake in the renamed BlackRock Global Investors). In France, Crédit Agricole and Société Générale are combining their operations. Having acquired a stake in BlackRock when it took over Merrill Lynch last autumn, Bank of America has put Columbia Management, its asset-management arm, up for sale.

Good day at BlackRock

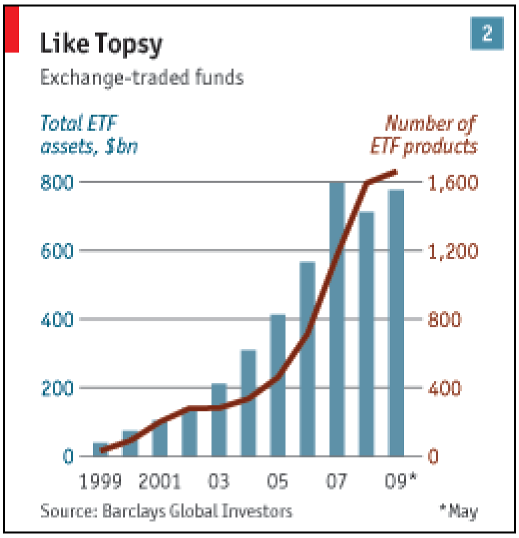
As the industry's revenues fall, buying another group's assets is appealing because it spreads costs across a wider base. BlackRock and Barclays are trumpeting the enhanced scale of their business (see chart 1). It will be the largest manager in a host of categories from equities to fixed income, as well as in total. In iShares it has the biggest name in exchange-traded funds (ETFs), a fast-growing

sector of quoted entities that mimic benchmarks such as the S&P 500 (see chart 2).

But not every bank has a fund-management arm as attractive as BGI. Having established a strong record in index tracking and in computer-driven stock-picking, it did not depend on its parent bank to bring in customers. In contrast, many banks acquired asset managers in an attempt to become financial "supermarkets", in which depositors would be sold products from other parts of the group. This approach, also called bancassurance, is standard in continental Europe, where most mutual funds are distributed through banks.



The model has its flaws. It is hardly plausible that any one bank would have the best products in every asset class. So customers are unlikely to be getting the best deal if they are sold a suite of a bank's products, something that has been noticed by the regulators. Hence there has been a move towards "open architecture", in which banks act more as distributors than manufacturers and sell products from across the industry.



Indeed, one reason why Barclays says it is selling BGI is that independent fund-managers have been gaining market share at the expense of bank-owned outfits. It estimates that independents' share of the assets run by the 50 largest managers rose from 36% in 1998 to 59% by last year. Barclays also says that some clients will not deal with asset-management firms that are part of investment banks, because of regulatory restrictions or concerns about conflicts of interest.

Whatever the reasons, banks are now reconsidering the advantages of owning a fund manager. "Over the last decade, the major acquirers of asset managers were commercial banks, investment banks and insurance companies," says Todd Ruppert of T. Rowe Price, a big independent fund manager. "In the next few years, they will be the major sellers."

The problem for any potential purchaser is whether the assets will stay put. If customers have bought funds merely on their bank's recommendation, they may not stay loyal for long. "If you buy a bank's asset manager, what are you buying?" says Massimo Tosato of Schroders. "The funds under management remain substantially under the control of the bank's branches."

Even when the seller is not a bank, mergers and acquisitions (M&A) in fund management are fraught with problems. "Clients don't like M&A, consultants don't like M&A and it seldom works because of investment culture and process," says Peter Harrison of RWC Partners, a London fund-management group.

Martin Gilbert of Aberdeen Asset Management is one of the industry's consolidators, having recently bought part of the business of Credit Suisse Asset Management. He says there has never been a better time to pursue opportunities, although he adds that the best deals involve buying assets to manage, rather than whole companies. "That way, you don't have the trouble of trying to integrate two cultures," he says. Fund managers are independent souls who don't like being dictated to by head office.

Private solutions

Purchases by private-equity groups may be the answer. Many of them have cash raised in the boom years of 2006 and 2007; fund managers have cashflows (from fees) that can be used to finance debt. Fund-

management groups also have little need for extra capital as they grow. Private-equity groups are already involved: Hellman & Friedman, a San Francisco group, owns Gartmore; and TA Associates, based in Boston, backed the management buy-out of Jupiter from Commerzbank.

Better still, banks wanting to sell their fund-management arms can lend private-equity firms the money to buy them. (Barclays originally arranged such a deal for a sale of iShares, although that has been abandoned in favour of selling the lion's share of BGI.) That is good news for the private-equity firms, which are finding it hard to get debt finance elsewhere. But owning fund-management groups is not without pitfalls, because they have no tangible assets against which debt can be secured. Their value lies in the fund managers themselves—and they are very mobile.

What is making the industry ripe for restructuring is its operational gearing. Managers earn fees, based on a proportion of assets under management. As share prices fall, margins decline and revenues may fail to cover fixed costs. Even without the huge falls in asset prices, reckons David Hunt, a consultant at McKinsey, the fundamental economics of the asset-management business have deteriorated. The revenue generated per dollar of assets may be about to decline by around a third.

In part, that is because of a change in asset mix. More money is being invested in bonds, at the expense of equities; the fees on fixed-income management are generally lower. And more is being invested in "passive" or index-tracking strategies rather than higher-charging "active" strategies intended to beat the benchmark.

In addition, fund managers can lack bargaining power. The industry is divided between those who aim for the retail market and those who look after money for institutions—pension funds, charities and foundations. It is possible for managers to have a fairly direct relationship with institutional clients, but fees are generally low. It is worth keeping prices down to attract a big pension fund and hence a critical mass of assets to manage.

On the retail side, finding customers is harder. Just relying on strong performance is not enough. Few savers, with the exception of those in America, have the confidence to go out and construct a portfolio on their own. Even in America, most mutual funds are bought through brokers. Mr Hunt points out that this market has just been consolidated. The share of the four biggest firms (today, Bank of America/Merrill, Smith Barney/Morgan Stanley, Wachovia/Wells Fargo and UBS) has climbed to 60% from somewhere in the low 40s before the financial crisis. Fund managers that want to crack the retail market will have to keep those distributors sweet.

So it is quite possible for fund managers to have a fantastic product, but no way to sell it. Sometimes they are competing with the in-house products of banks, which continue to dominate distribution in Europe. Even when they can sell their funds, the process usually involves paying a commission, or "retrocession", to the distributor. This retrocession is taken out of the annual fee, pushing such fees higher and reducing clients' returns. In some cases, the better the product sells, the higher the fees and worse the clients may end up doing.

To aggravate matters, fund managers can find that intermediaries churn funds as they seek to generate income from their clients, causing assets to disappear as fast as they arrive. In Europe and Asia, net inflows are driven by fund launches. That often involves getting clients to invest in fashionable sectors at the top of the market (think back to the dotcom boom). In the three years to the end of 2008, 10,000 funds were created in Europe alone. The result tends to be unsatisfactory for both investors and managers.

The scale conundrum

The proliferation of funds in Europe points to another problem: the paradox of scale. In many industries, as companies get bigger, they cut costs and thus prices to customers. A few giants dominate by virtue of low costs, leaving room for niche players, and all the middle-sized companies get squeezed out. This is not so in fund management. In much of the industry scale seems to be self-limiting. No one is anywhere near big enough to dominate it. Even the combined BlackRock/BGI will have only 3-5% of the global sum of assets under management.

Some economies of scale exist. Back-office expenses such as technology and compliance do not rise one-for-one with assets under management. In index tracking, the bigger you get, the lower your costs, and the more closely you follow the index. In addition, bigger fund-management groups can spend more on

advertising and attract even more money.

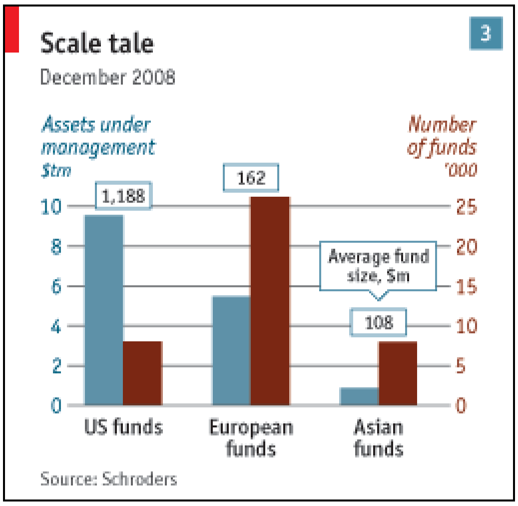
Nevertheless, it does seem that firms often become leading lights of the industry only to be brought down to size. The typical life-cycle of a firm is that it creates a successful performance record, attracts lots of assets, enjoys rapid growth of profits and then reaches a plateau as performance starts to tail off and star managers drift elsewhere. To make matters even more difficult, the markets, like circus clowns, always seem to have a custard pie at the ready. Just when a fund manager seems to be riding high, like Janus in 2000 or Legg Mason in 2005, a period of dismal performance comes along that makes a mess of its reputation. Assets under management disappear and the patient building process has to start all over again.

Nigel Wightman of Titanium Asset Management points out that in active management (ie, trying to beat an index) investment is not really scalable. Often, there is a natural limit to the size of equity portfolios: if they become too big they start to resemble expensive index funds. “Once you get very large, the cost of implementing decisions starts to whittle away your advantage,” says Mr Wightman. If a small fund manager wants to buy $1m-worth of a stock, it probably won’t move the price; if a big one wants $1 billion-worth, it surely will. And getting out of a big position may take even longer than getting in.

To add to the costs, many asset-management companies tend to offer a complete range of funds, covering everything from Asian equities to Treasury bonds. In theory, this allows them to meet all of a client’s needs; it also means they are almost certain to have some funds that are performing well, just by the law of averages. But they end up with a long tail of lossmaking funds.

Last December there were more than 26,000 European mutual funds, compared with just over 8,000 in America. But the American industry had almost €3 trillion ($4.2 trillion) more in assets. As a result, the average fund in Europe is less than one-seventh of the size of its American counterpart. In Asia, the average fund is smaller still (see chart 3).

Small funds are not ideal for anyone. Lipper, an information group, reckons that the median European fund has €25m of assets, barely enough to be economic to run. It also means higher average costs for clients. Funds with less than €20m of assets tend to have expense ratios of more than 2%. Those with more than €500m have ratios of around 1.5%.



Model behaviour

As well as the bancassurance groups, several other templates for running fund-management groups exist. At one end are the monolithic brands like Fidelity. The company has immense name recognition, giving it an advantage in mutual funds and in selling to investors in 401k (American personal pension) plans. Breaking through in the institutional business has been a harder slog, which is one reason why Fidelity has established a separate business, Pyramis, in this area. BlackRock is another example of a firm operating with one brand name and one integrated platform.

A second potential approach is the family of firms, exemplified by Allianz, a German insurer, and the Bank of New York Mellon. Such companies use a host of brand names: Allianz owns PIMCO, a bond manager; Bank of New York Mellon has Dreyfus, an equity mutual-fund group. The individual firms benefit from cost savings in areas such as technology and from the marketing clout that comes from being part of a bigger group. The parent benefits from a diversified stream of earnings. At any given moment, it is likely that at least one of its fund managers will be performing well. Nevertheless, there are still some questions over this model. Will the parent company really allow the fund managers complete investment freedom? And will all the subsidiaries get a fair crack of the marketing whip or will those that charge the most be favoured?

The third template is the boutique—a firm that specialises in a niche area such as emerging markets. Boutiques will always exist. It does not take much capital to start a fund manager and investors are usually willing to follow outperformers when they switch companies. “If you are small and focused and can deliver a good product, you will survive,” says Martin Huber of McKinsey. Nevertheless, boutiques are perennially exposed to the risk of a couple of years of underperformance, or simply a sharp fall in prices in their chosen

sector, which can cause assets under management to fall below critical mass. They also have a succession problem: if the founders want to retire, they can find it difficult to realise the value of the business.

The biggest area of expansion for boutique managers over the past decade has, of course, been in hedge funds. The number of these funds tripled to more than 10,000 between 1998 and 2007. Fee income turned some hedge-fund managers into billionaires.

Illustration by Otto Dettmer

But poor performance in 2008, when the average hedge fund lost 19%, has led to a mass exit of clients and managers. Assets under management have fallen by a third and performance fees have fallen sharply. Clients may have committed money to the sector rather blindly. When it comes to choosing (and paying) asset managers, “there needs to be more focus on the issue of what is skill and what is market return,” says Paul Trickett of Watson Wyatt, a firm of consultants. Institutional clients such as CalPERS, a huge pension fund for California’s public employees, are taking the lead, negotiating lower fees and stiffer performance targets.

Active fund managers thus face a squeeze from all sides. Not only have their revenues from alternative asset classes such as hedge funds been declining, they also face the prospect of losing retail clients to ETFs. It will also take time to recover from the bear market. Andy Maguire of Boston Consulting Group thinks it is hard to see assets under management regaining the levels of 2007 until 2013 at the earliest.

Improving profits may thus require cutting costs, and that means fewer jobs. A report by Watson Wyatt found that expenditure on staff accounts for more than half the total. The consultancy estimates that British asset managers are looking to reduce costs by around 20% and employment by 10%.

That is easier today than it would have been two years ago. A component of star fund managers’ pay usually varies with performance and this will decline. An executive quoted in the Watson Wyatt report remarked: “There will be no pay rise this year and the bonus is that you still have a job.” In less lean times companies would worry about losing talented fund managers, but anyone thinking of leaving is unlikely to get a better offer elsewhere. And these days there is much less allure for managers in decamping to start their own hedge funds.

Lower costs would be good for clients, too. “Reducing total expense ratios by 30 to 50 basis points can have a major impact on net customer returns over 20 years,” says Mr Tosato of Schroders.

Having faced difficult times in the markets, managers now face the challenge of getting their own business in shape. That is not something they will necessarily be good at. “Fund-management groups often have too many portfolio managers and too few business managers,” says McKinsey’s Mr Huber. That is why a lot of firms will be looking to see if the deal between BlackRock and BGI can be made to work. If it can, many more will follow.

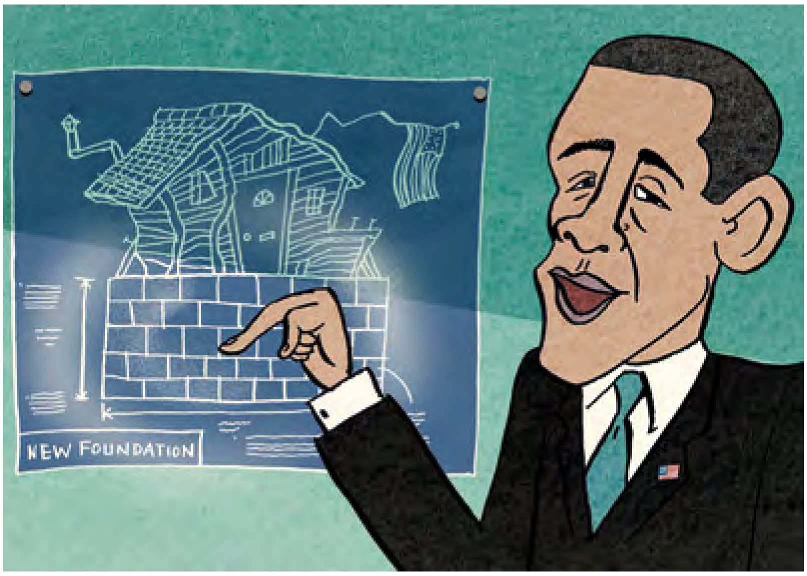
Financial reform in America

New foundation, walls intact

Jun 18th 2009 | NEW YORK
From The Economist print edition

A much-trailed financial overhaul is a curious mix of audacity and timidity

Illustration by S. Kambayashi



EVEN Merton Miller, a Nobel prize-winning economist with a passion for financial arcana, found it "deadly dull". But if ever there was a week when financial regulation set pulses racing, this was surely it—at least for those too young to remember the great reforms of the Depression.

Having spent much of the past year trying to prevent all-out financial collapse, America's leaders are now turning their attention to reinforcing the structures that would prevent a repeat. The proposals that Barack Obama unveiled on June 17th would refashion the federal rules governing almost every corner of finance, pushing government much more deeply into private markets and partially rolling back 30 years of liberalisation. It is, the president declared, nothing short of a "new foundation", designed to curb "risks built on piles of sand".

Eye-catching though the 88-page "white paper" is, it is not as bold as it might have been. In any case, it merely sounds the opening salvo in a battle that could stretch into next year, since much of the plan requires approval in Congress, where jurisdictional and ideological clashes beckon.

The emphasis is on closing gaps where risk had been allowed to build up. Supervision of all firms big enough to threaten overall stability will be consolidated under the Federal Reserve. These entities will be made to hold more capital and liquidity than smaller firms, though all will face higher requirements (which will be determined after a report at the end of this year). The Fed will be advised by a council of regulators that will also scan the horizon for emerging risks. Another priority is the construction of a mechanism to wind down any failed financial giant, not just banks, so that officials no longer face an unenviable choice between bail-outs (AIG) and system-shaking collapse (Lehman Brothers).

The net is also being cast over markets in which freewheeling growth contributed to the crisis. Those who package loans together for securitisation will have to beef up disclosure and retain 5% of any deal they structure to encourage sounder underwriting—though the ban on hedging that exposure could be tricky to enforce. Sensibly, the plan calls for payment of arrangers' fees to be spread over time and reduced if the loans blow up. It also builds on earlier proposals to rein in over-the-counter derivatives, such as credit-default swaps. Those not cleared centrally or traded on exchanges face higher charges.

Perhaps the most eye-catching—and certainly the most populist—measure is the creation of a Consumer Financial Protection Agency (CFPA). Taking some powers from the Fed and other bank regulators, this would have broad rule-writing and enforcement powers over mortgages, credit cards and the like. In light of the “liar loans” and option ARMs (a radioactive type of mortgage) that proliferated in recent years, it is hard to argue against an overhaul of such regulation. Still, concern is already mounting that the new agency will take an overly restrictive view of permissible products, limiting access to credit and curbing good as well as bad innovation. Others worry that it will have less leverage than traditional supervisors over banks peddling dodgy products.

A bigger concern is Mr Obama’s failure to rationalise America’s tangle of regulators. The Office of Thrift Supervision (OTS) will be subsumed into another agency, but that still leaves four federal bank regulators (plus state agencies), and these will have to work alongside the CFPA. “The alphabet soup has lost three letters and gained four,” moans one consultant.

Dropping the idea of a single bank regulator and a merger of the agencies that oversee securities and derivatives, both of which were early Obama goals, was, say officials, a cold-blooded calculation based on the strength of political opposition: from congressional leaders, such as Barney Frank, who have cooled to the idea of a unified regulator in the wake of Britain’s unhappy experience; and from the committees that police, and take contributions from, banks and exchanges.

Leaving the framework largely intact is risky. The current set-up is not all bad: one regulator may spot a problem that another misses. But even with the OTS gone, banks will be able to shop for friendly charters. Disagreements between agencies over the dangers lurking in commercial property led to a delay in urging banks to tighten standards. And inter-agency feuding has been growing: witness the spats between the Federal Deposit Insurance Corporation and other regulators over deposit insurance and their treatment of Citigroup.

Other punches have been pulled, too. For big insurers, frustrated at having to be regulated state by state, the wait for an optional federal charter goes on. Nor were concrete proposals offered on money-market funds, runs on which intensified the trauma following Lehman’s demise. Officials argue, with some justification, that these omissions are sound tactics: Congress can swallow only so much esoteric reform in one go.

Even without these measures, the white paper may get pulled apart. There is unease on Capitol Hill over an expanded role for the Fed and continued Balkanisation. Bank lobby groups will try to water down the consumer agency’s powers and to persuade lawmakers that higher capital requirements will curb lending to hard-working Americans (and put the industry at a disadvantage to international rivals). The reforms must jostle with other initiatives, such as health care, for legislative time. Some doubt their chances of passing in any form until next year. The new foundation’s plans may have been drawn up; its final shape and timing are uncertain.

TPG exits Shenzhen Development Bank

Money from another time

Jun 18th 2009 | HONG KONG
From The Economist print edition

A foreign banking expedition in China reaches a premature but successful end

BACK in 2004, when China was more convinced that the West had something to offer its financial system, TPG, an American private-equity firm, was permitted to bypass the country's restrictive regulations and buy a controlling 17% stake in a publicly traded basket case called Shenzhen Development Bank (SDB). The news, on June 12th, that TPG is to sell its stake to Ping An, a large Chinese insurer, draws another line under that era.

SDB was the first bank to list on Shenzhen's stock exchange, and in the craze that followed the shareholder list swelled to more than 600,000 individuals. But by the time of TPG's purchase, it was in a sorry state. Disclosed non-performing loans accounted for 14% of loans; the actual amount was undoubtedly much higher.

SDB did, however, have several assets that in the Chinese context were almost priceless: a national banking licence and more than 260 branches covering almost all of the country. The potential for a banking collapse was enough for the Chinese authorities to waive rules barring foreign control, foreign management and foreign purchases of domestic shares. The potential in China's embryonic banking market was enough for TPG to take a chance.

In the aftermath of the acquisition performance improved, as did SDB's share price. But there were limits on further progress. Writing off bad loans, building systems and extending more credit requires capital, but SDB's various efforts to raise funds could not get past China's regulators. This is unlikely to be a problem for Ping An, which is well-treated at home but found itself lost abroad after a calamitous recent investment in Fortis, a now-dismantled European bank. In theory Ping An has the resources to address SDB's capital needs, and could pair its domestic insurance franchise with SDB's national banking reach.

For TPG, being seen to have rehabilitated a bank and successfully passed it on could open doors for future deals that China's increasingly xenophobic regulators would be otherwise unlikely to approve. After a disastrous investment in Washington Mutual, a failed American bank, TPG was also doubtless under pressure to show some gains for investors. Although the terms are complex and not fully public, TPG put less than $300m into SDB (perhaps much less) and will take out more than $1.6 billion (perhaps much more).

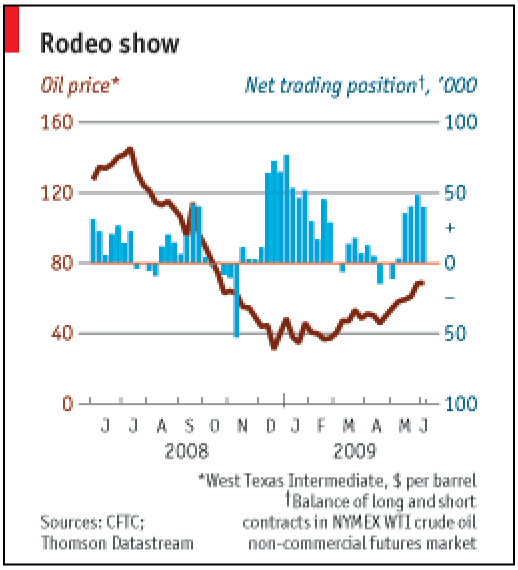
The size of TPG's returns has prompted reports that the deal may be blocked by officials. No private-equity firm likes having its exit strategy undermined but this would be no disaster. Barring another round of banking failures, no foreign firm will be granted a similar franchise in China for years to come. Even with strings attached, TPG would be hard-pressed to find a more interesting place for its money.

Explaining the oil-price rally

Taming a wild beast

Jun 18th 2009
From The Economist print edition

As oil prices surge, so do worries about speculation



THE oil market, born in Texas, is behaving like a bucking bronco again. Prices that careened from $147 a barrel in mid-2008 to $31 before the end of last year have jumped back to around $70 in recent days. Mindful that high oil prices could thwart an economic recovery, politicians are again blaming speculators for this unruly behaviour. Positions held on NYMEX, the New York commodities exchange, by investors expecting prices to rise have indeed soared (see chart).

It is difficult to assemble a definitive explanation for the rally. There is hope that the world financial system has escaped collapse and that global growth may improve soon. A weak dollar helps oil prices. But evidence of improving supply and demand in the crude-oil market remains thin: a bit more production restraint by the Organisation of Petroleum Exporting Countries; some stock-building in China; and a levelling off of inventories in the rich world.

Proving that speculative investors are to blame for the volatility is also tricky. In 2008 America's Commodity Futures Trading Commission (CFTC), which regulates NYMEX, examined how the changing positions of hedge funds affect prices. It found correlation, not causation—speculators were clinging on for the ride, not making the beast buck.

But the CFTC's investigations were hampered by the fact that it could not examine intra-day trades. Nor could it monitor certain derivatives, such as those traded via London's InterContinental Exchange (ICE), in which Wall Street dealers are particularly prominent.

This lack of transparency alarms the regulators—and their political masters. In a sign of things to come in the oil market, on June 12th the CFTC said it had launched an unprecedented public investigation to see whether the biggest natural-gas contract traded on ICE was moving prices around in the more regulated futures markets. If so, those trading it may become subject to the position limits that traders on NYMEX face.

The CFTC's new chairman, Gary Gensler, has come into office determined to broaden such initiatives to encompass the derivatives market as a whole. But his aim is to use transparency to create a more orderly market, not to set prices. That makes sense. Speculators do bring real information to prices—the bullish ones may, for example, be hoarding oil in the belief that prices will rise. But they will only make money in the long run if the fundamentals of supply and demand bear them out. If not, they will be tossed about just as badly as everyone else.

CDSs and bankruptcy

No empty threat

Jun 18th 2009
From The Economist print edition

Credit-default swaps are pitting firms against their own creditors

SIX FLAGS, an American theme-park operator, filed for Chapter 11 bankruptcy protection on June 13th, bringing its long ride to reduce debt obligations to an abrupt halt. The surprise was that bondholders, not the tepid credit markets, stymied the restructuring effort. Bankruptcy codes assume that creditors always attempt to keep solvent firms out of bankruptcy. Six Flags and others are finding that financial innovation has undermined that premise.

Pragmatic lenders who hedged their economic exposure through credit-default swaps (CDSs), a type of insurance against default, can often make higher returns from CDS payouts than from out-of-court restructuring plans. In the case of Six Flags, fingers are pointing at a Fidelity mutual fund for turning down an offer that would have granted unsecured creditors an 85% equity stake. Mike Simonton, an analyst at Fitch, a ratings agency, calculates that uninsured bondholders will receive less than 10% of the equity now that Six Flags has filed for protection.

Some investors take an even more predatory approach. By purchasing a material amount of a firm's debt in conjunction with a disproportionately large number of CDS contracts, rapacious lenders (mostly hedge funds) can render bankruptcy more attractive than solvency.

Henry Hu of the University of Texas calls this phenomenon the "empty creditor" problem. About two years ago Mr Hu began noticing odd behaviour in bankruptcy proceedings—one bemused courtroom witnessed a junior creditor argue that the valuation placed on a firm was too high. With default rates climbing, he sees such perverse incentives as a looming threat to financial stability. Already the bankruptcies of AbitibiBowater, a paper manufacturer, and General Growth Properties, a property investor, in mid-April have been blamed on bondholders with unusual economic exposures. Some also suspect that CDS contracts played a role in General Motors' filing earlier this month.

Getty Images

Downhill from here

Solutions to the problem are, so far, purely theoretical. One option would be regulation requiring disclosure by investors of all credit-linked positions. There is now almost no disclosure of who owns derivatives on a company's debt, leaving firms to guess how amenable creditors will be when approached with a restructuring plan. Longer-term solutions rest on an overhaul of the bankruptcy code and debt agreements to award votes and control based on net economic exposure, rather than the nominal amount of debt owned. Supporters of the market point to the value of CDSs in reducing the cost of capital and to plans for a central clearing house that will reduce redundancy and increase transparency. But the reform roller-coaster has not yet come to a halt.

Investment spending in China

Reap what you sow

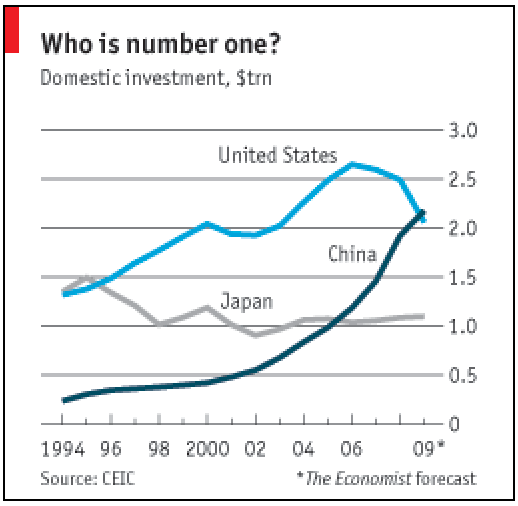
Jun 18th 2009 | HONG KONG
From The Economist print edition

China's capital spending could soon be bigger than America's

DESPITE falling exports, China's economic growth has remained relatively strong this year thanks to a surge in investment sparked by the government's stimulus measures. Official data show that fixed-asset investment leapt by an astonishing 39% in the year to May, or by a record 49% in real terms. Sowing more today should yield a bigger harvest tomorrow, but how wisely is this capital being used?

Official figures almost certainly overstate the size of the spending boom: local bureaucrats may well be exaggerating investment in order to impress their masters in Beijing. More important, the government's figures misleadingly include land purchases and mergers and acquisitions. But even if measured on a national-accounts basis, like GDP, investment is probably growing at a still-impressive real annual rate of around 20%. This year China's domestic investment in dollar terms is likely to exceed that in America (see chart).

There is widespread concern that this investment boom is adding to China's excess capacity. Investment amounted to 44% of GDP last year (compared with 18% in America), which many economists reckon was already too much. Worse still, as well as forcing state firms to invest, the government is directing state-owned banks to lend more, despite falling corporate profits. Many of those loans could turn sour. Like Japan in the 1980s, it is argued, an artificially low cost of capital causes chronic overinvestment and falling returns. If so, it will end in tears. To assess that risk you need to ask two questions. How much excess capacity was there already? And where is the new investment going?



There is certainly excess capacity in a few sectors (steel and some export industries, such as textiles). But the best measure of spare capacity for the economy as a whole—the difference between actual and potential GDP, or "output gap"—is probably only about 2% of GDP, compared with an average of almost 7% in the rich world.

The large role played by state-owned banks is bound to have resulted in some misallocation of capital, but a recent study by Helen Qiao and Yu Song at Goldman Sachs argues that concerns about overinvestment are exaggerated. A successful developing economy should have a high ratio of investment to GDP. And a rising rate does not mean that the efficiency of capital is falling; capital-output ratios are supposed to increase as economies develop. America's capital stock is much larger relative to its GDP than China's, with 20 times more capital per person than in China.

A better measure of capital efficiency is profitability. Profits have indeed slumped over the past year, but taking the past decade to adjust for the impact of the economic cycle, profit margins have not narrowed as one might expect if there were massive spare capacity. The argument that the average cost of capital is ludicrously low is also no longer true. China's real interest rate is now 7%, which is among the highest in the world.

Where is the new investment going? There has been little new spending in industries with overcapacity, such as steel and computers. But the surge in state-directed investment has fuelled fears about its quality. In its latest *China Quarterly Update*, the World Bank calculates that government-influenced investment so far this year was 39% higher (on a national-accounts basis) than a year earlier, while "market-based" investment rose by a more modest 13%. This implies that government-influenced investment accounts for about three-fifths of the growth in investment this year, up from one-fifth last year.

The usual assumption is that government investment is less efficient and will therefore harm long-term growth. But the fastest expansion in spending has been in railways (up by 111% this year). As a developing country, China still lacks decent infrastructure; railways, in particular, have long been an economic bottleneck. Investment in roads, the power grid and water should also yield high long-term returns by allowing China to sustain rapid growth.

And the government is focusing its infrastructure stimulus on less developed parts of the country where the benefits promise to be greatest. According to Paul Cavey at Macquarie Securities, fixed-asset investment in western provinces was 46% higher in the first four months of this year than in the same period of 2008, almost double the rise in richer eastern provinces.

Some of the money being spent in China will inevitably be wasted, but it is wrong to denounce all government-directed investment as inefficient. In the short term it creates jobs, and better infrastructure will support future growth. It is certainly not a substitute for the structural reforms needed to lift consumer demand in the longer term, but it could help. After all, without running water and electricity, people will not buy a washing machine.

Economist.com FINANCE & ECONOMICS

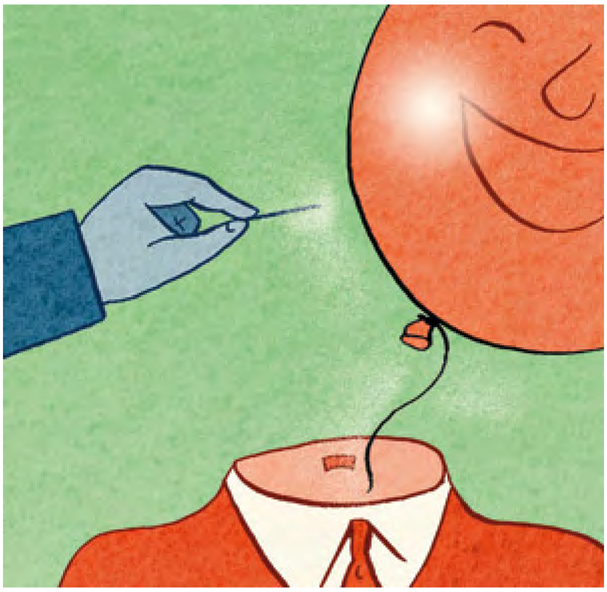
Buttonwood

Not so fast

Jun 18th 2009
From The Economist print edition

Appetite for risk may have returned, but the crisis is not over

Illustration by S. Kambayashi



LOW interest rates are intended to ease the burden on debtors, discourage saving, encourage spending and thereby revive the economy. But they also have a distorting effect on asset markets. By reducing the cost of speculation, they encourage bubbles.

So although it is good news that some indicators (such as the cost of bank borrowing) have improved, risk appetites also need monitoring closely. The “search for yield” which marked the boom of 2005, 2006 and early 2007 seems to have started again. Retail investors, disappointed with measly returns on savings accounts, are piling into corporate-bond funds. One British manager is reportedly raking in £1 billion ($1.6 billion) a month.

Those investors will have to hope that the managers choose their bonds wisely. Standard & Poor’s, a credit-rating agency, reports that more companies have defaulted in 2009 than in the whole of last year, and expects the default rate, 7.29% in May, to hit 14.3% by next year. The agency’s “weakest link” category contains 290 firms, with nearly $370 billion of debt, that are deemed to be at risk of failure.

The banks are also rediscovering their willingness to take risks. In a review of the investment-banking sector on June 15th, JPMorgan said that rival banks, eager to rebuild market share, are offering to do deals at “irresponsible prices”.

The silver lining to this cloud is that large companies have been able to take advantage of investor enthusiasm to raise money in both the bond and equity markets. J. Sainsbury, a British supermarket group, launched a £445m rights issue on June 17th to fund expansion plans. The very idea would have been unimaginable three months ago.

All this is encouraging the feeling that the worst of the crisis is over. Equity markets enjoyed an almost uninterrupted rebound between March and mid-June; according to Société Générale, the MSCI World index rose in 13 out of the 14 weeks to June 12th, the best sequence since December 1999. This, in turn, was linked to the feeling that the worst of the recession was seen in the first quarter, and that the global economy could be rebounding by the second half of this year.

There is a kind of positive feedback loop here, in which confidence about the economy boosts the stockmarket and a rising market helps restore economic sentiment (indeed, share prices are included in leading indicators). As strategists at Citigroup remark, the world seems to have moved from worrying about the Great Depression to talking about the Great Escape.

But how real is this shift? Not all the recent economic data have been positive. The June Empire State survey of manufacturing activity in New York showed a retreat. German export figures for April showed a 4.8% month-on-month fall. The latest figures for American and euro-zone industrial production showed similar dips. American raw domestic steel production is down 47% year on year; railway traffic in May was almost a quarter below its level of a year earlier. Bankers say that chief executives seem a lot less confident about the existence of “green shoots” than markets are.

The danger is that policymakers have done more to revive the financial markets than they have to shore up the real economy. Tim Lee of pi Economics thinks the authorities are simply inflating another bubble. The carry trade (borrowing in low-yielding currencies to invest in higher-yielding ones) has returned, as shown by the strength of the Australian dollar.

This bubble may start to deflate. Investors are already rediscovering their appetite for government bonds: the yield on ten-year Treasuries had drifted back from a peak of 3.93% on June 10th to 3.67% a week later. Investors may be starting to realise that, even if the biggest falls in output have passed, the outlook for 2010 is still likely to be sluggish.

After all, the problems that existed at the start of this crisis have not gone away. Delinquencies on American mortgage loans are still rising: the seasonally adjusted rate in the first quarter was higher across all categories. European banks may still need to write down another $283 billion of assets this year and next, according to the European Central Bank. Worst of all, Capital Economics says American consumer debt is more than 130% of disposable income, double its level in the 1980s. Reducing this ratio will require widespread defaults, rapid inflation or a prolonged period of higher savings rates. None of those would be particularly good news for the markets. The crisis took a long time to build up. It will not disappear as a result of one good quarter.

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Economics focus

The lessons of 1937

Jun 18th 2009
From The Economist print edition

In a guest article, Christina Romer says policymakers must learn from the errors that prolonged the Depression

AP

Christina Romer is the chairwoman of Barack Obama's Council of Economic Advisers and a scholar of the Depression

AT A recent congressional hearing I cautiously noted some "glimmers of hope" that the economy could stabilise and perhaps start to rebound later in the year. I was asked if this meant that we should cancel much of the remaining spending in the $787 billion American Recovery and Reinvestment Act. I responded that the expected recovery was both months away and predicated on Recovery Act spending ramping up greatly. Only later did it hit me that I should have told the story of 1937.

The recovery from the Depression is often described as slow because America did not return to full employment until after the outbreak of the second world war. But the truth is the recovery in the four years after Franklin Roosevelt took office in 1933 was incredibly rapid. Annual real GDP growth averaged over 9%. Unemployment fell from 25% to 14%. The second world war aside, the United States has never experienced such sustained, rapid growth.

However, that growth was halted by a second severe downturn in 1937-38, when unemployment surged again to 19% (see chart). The fundamental cause of this second recession was an unfortunate, and largely inadvertent, switch to contractionary fiscal and monetary policy. One source of the growth in 1936 was that Congress had overridden Mr Roosevelt's veto and passed a large bonus for veterans of the first world war. In 1937, this fiscal stimulus disappeared. In addition, social-security taxes were collected for the first time. These factors reduced the deficit by roughly 2.5% of GDP, exerting significant contractionary pressure.

Also important was an accidental switch to contractionary monetary policy. In 1936 the Federal Reserve began to worry about its "exit strategy". After several years of relatively loose monetary policy, American banks were holding large quantities of reserves in excess of their legislated requirements. Monetary policymakers feared these excess reserves would make it difficult to tighten if inflation developed or if "speculative excess" began again on Wall Street. In July 1936 the Fed's board of governors stated that existing excess reserves could "create an injurious credit expansion" and that it had "decided to lock up" those excess reserves "as a measure of prevention". The Fed then doubled reserve requirements in a series of steps. Unfortunately it turned out that banks, still nervous after the financial panics of the early 1930s, wanted to hold excess reserves as a cushion. When that excess was legislated away, they scrambled to replace it by reducing lending. According to a classic study of the Depression by Milton Friedman and Anna Schwartz, the resulting monetary contraction was a central cause of the 1937-38 recession.

The 1937 episode provides a cautionary tale. The urge to declare victory and get back to normal policy after an economic crisis is strong. That urge needs to be resisted until the economy is again approaching full employment. Financial crises, in particular, tend to leave scars that make financial institutions, households and firms behave differently. If the government withdraws support too early, a return to economic decline or even panic could follow. In this regard, not only should we not prematurely stop Recovery Act spending, we need to plan carefully for its expiration. According to the Congressional Budget

Office, the Recovery Act will provide nearly $400 billion of stimulus in the 2010 fiscal year, but just over $130 billion in 2011. This implies a fiscal contraction of about 2% of GDP. If all goes well, private demand will have increased enough by then to fill the gap. If that is not the case, broad policy support may need to be sustained somewhat longer.

Perhaps a more fundamental lesson is that policymakers should find constructive ways to respond to the natural pressure to cut back on stimulus. For example, the Federal Reserve's balance-sheet has more than doubled during the crisis, drawing considerable attention. Monetary policymakers have made it clear that they believe continued monetary ease is appropriate. Moreover, the Fed's credit programmes are to some degree self-eliminating: as demand for its special credit facilities shrinks, so will its balance-sheet. But now may also be a sensible time to grant the Fed additional tools to help its balance-sheet contract once the economy has recovered. Some have suggested that the Fed be authorised to issue debt, as many other central banks do. This would enhance its ability to withdraw excess cash from the financial system. Granting such additional tools now could provide confidence that the Fed will be able to respond to inflationary pressures, without it having to create that confidence by actually tightening prematurely.

Fiscal health check

Now is also the time to think about our long-run fiscal situation. Despite the large budget deficit President Obama inherited, dealing with the current crisis required increasing the deficit substantially. To switch to austerity in the immediate future would surely set back recovery and risk a 1937-like recession-within-a-recession. But many are legitimately concerned about the longer-term budget situation. That is why the president has laid out a plan to shrink the deficit he inherited by half and has repeatedly emphasised the need to reduce the long-term deficit and put the debt-to-GDP ratio on a declining trajectory. In this regard, health-care reform presents a golden opportunity. The fundamental source of long-run deficits is rising health-care expenditures. By coupling the expansion of coverage with reforms that significantly slow the growth of health-care costs, we can dramatically improve the long-run fiscal situation without tightening prematurely.

As someone who has written somewhat critically of the short-sightedness of policymakers in the late 1930s, I feel new humility. I can see that the pressures they were under were probably enormous. Policymakers today need to learn from their experiences and respond to the same pressures constructively, without derailing the recovery before it has even begun.

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Economist.com SCIENCE & TECHNOLOGY

Black holes on a desktop

Dumb insolence

Jun 18th 2009
From The Economist print edition

Sound may offer a better way than light to test Stephen Hawking's prediction that black holes emit radiation

Illustration by David Simonds

WHEN the Large Hadron Collider, a giant particle accelerator near Geneva, was switched on last September, the press was full of scare stories about the risk of it producing a tiny black hole that would, despite its minuscule size, quickly swallow the Earth. In fact, the first test runs could never have made such an object. And, just over a week later, the LHC broke and has not yet been repaired. But it is true that one of the things its operators would like to create, if and when they get it going again, are miniature versions of those fabled astronomical objects whose intense gravity means no light can escape them.

Among their reasons for this aspiration is a wish to examine Stephen Hawking's famous but untested prediction that, despite their famous blackness, black holes do actually emit radiation, including light. But if they do not get the LHC running pronto, they may find themselves beaten to the prize of producing this so-called Hawking radiation by an experiment being carried out on a desktop in a laboratory in Haifa.

The desktop in question belongs to Jeff Steinhauer, a physicist at the Technion-Israel Institute of Technology. Dr Steinhauer has followed a suggestion made in 1981 by William Unruh of the University of British Columbia and created an analogue of a real black hole in the laboratory, using an extremely cold form of matter called a Bose-Einstein condensate. By studying this analogue, dubbed a "dumb hole" because it swallows sound rather than light, he and his colleagues hope to get a better understanding of the real thing—and, in particular, of Hawking radiation.

The hole story

Real black holes' light-swallowing abilities make them notoriously difficult to observe directly, though their gravitational effects on their surroundings can be seen. Some, such as those around which galaxies are believed to accrete, formed just after the beginning of the universe. A lot, though, are the result of huge

stars collapsing in on themselves at the end of their lives. Whatever their origin, all black holes have an "event horizon", within which gravity is so intense that nothing can escape.

In the 1970s, however, Dr Hawking, a physicist at Cambridge University, used quantum mechanics to predict that black holes are not, in fact, completely black. Heisenberg's uncertainty principle, one of the central tenets of quantum mechanics, maintains that you cannot pin down all the physical properties of a particle at the same time. Among other curiosities, this leads to the startling idea (which has been proved experimentally) that a vacuum is not empty space. Instead, it is filled with pairs of "virtual" particles and their antiparticles, which pop into existence for a fraction of a second before recombining with one another and disappearing again.

But near a black hole's event horizon things can go wrong. A virtual particle or antiparticle may be captured by the black hole's gravity. Once within the event horizon, it cannot escape and its abandoned partner has no option but to become real. The energy needed for this "realisation" comes from the black hole itself, which thus shrinks and eventually evaporates. Meanwhile, the newly real particles decay, giving off (among other things) light, X-rays and gamma rays. Though this radiation is too weak to be detected by telescopes, it would be detectable if the LHC did make a tiny black hole. Indeed, any such hole would evaporate so fast that it would not have time to cause trouble.

A little while after Dr Hawking worked all this out, Dr Unruh pointed out that if you have a body of fluid which contains a region that is flowing supersonically, sound waves would be trapped inside that region. In other words, the boundary between the supersonic and subsonic regions would do for sound waves what the event horizon does for light.

What makes this interesting is that, just as light can be analysed as either waves or particles, the same is true of sound in some circumstances. And particles of sound, known as phonons, are just as susceptible to Heisenberg's uncertainty principle as particles of light (photons)—or, indeed, any other fundamental particle. The upshot is that pairs of virtual phonons are appearing and disappearing all the time, and if one gets trapped inside a supersonic boundary, the other should be released into the wider world to make a noise.

Dr Steinhauer and his colleagues have not yet detected sonic Hawking radiation, but they have taken the first step: they have produced a dumb hole. Their tool, the Bose-Einstein condensate, is a superchilled soup of matter that can be created only when the temperature is near absolute zero. At this temperature, atoms almost stop moving. As a consequence, the wavelengths of the chilled atoms become very large (atoms, like everything else, are both particles and waves). That causes the waves to overlap and creates a kind of collective atom—as predicted by Satyendra Bose and Albert Einstein in 1924.

Since they were first made in 1995, Bose-Einstein condensates have become commonplace as experimental tools. (They are particularly valued for their ability to slow the speed of light all the way down to zero.) Dr Steinhauer and his colleagues created a condensate out of a gas of rubidium atoms held in a magnetic trap. They then compressed and decompressed the gas, which generated sound waves. They took photographs and used them to calculate both the speed of flow and the speed of sound within the condensate. Their data showed that the speed of part of the condensate exceeded the speed of sound, and they had therefore made an acoustic event horizon.

The next step is to look for Hawking phonons. That will mean making new apparatus, which could take a while. Nevertheless, with the LHC not scheduled to re-open for testing until the autumn—and, even after that, not guaranteed to produce any black holes—there is a good chance that the first Hawking radiation observed will be of a sort that even Dr Hawking never conceived of in his wildest dreams.

Economist.com SCIENCE & TECHNOLOGY

High-tech dentistry

St Elmo's frier

Jun 17th 2009
From The Economist print edition

Using a plasma torch to clean your teeth

Science Photo Library

Getting to the root of it

INFECTIONS in the roots of teeth are hell to treat. The tooth needs to be drilled into, right down to the bottom of the nerve-carrying canal that runs through the root. The infected material must then be cleaned out completely and the drilled section filled in. Although the procedure is routine, it is common for some of the bacteria to survive it and therefore for infections to re-emerge shortly after treatment.

The surviving bacteria are often gathered in the form of what is known as a biofilm. Bacteria in such a film are embedded in a polymer matrix, which makes them harder to kill than isolated individuals. High temperatures can destroy biofilms, as can some chemicals, but neither approach is safe to use inside the delicate interior of a human tooth. However Chunqi Jiang, a physicist at the University of Southern California, Los Angeles, and her colleagues have come up with a possible alternative: a dental plasma torch.

Plasmas are gases in which the molecules have been stripped of some or all of their electrons, to create positive ions. One way to do this is to heat the gas up. Conventional plasma torches employ such hot plasma to cut metal. But cold plasmas can be made using high electrical voltages. St Elmo’s fire—violet and blue “flames” that appear around ships’ masts during thunderstorms—is a good example. Dr Jiang reckoned that a cold plasma, particularly one rich in oxygen ions (which are notoriously destructive of organic materials), would be enough to do the job of breaking up a biofilm without harming the patient.

To test this idea, she and her colleagues designed a device that uses short pulses of electricity to ionise the surrounding air, creating a purple plume of plasma rich in oxygen ions. And it worked. The team report in *Plasma Processes and Polymers* that when the plume was directed into the infected interiors of teeth, it succeeded in clearing up well-established infections completely.

That may just be the beginning. Bacteria in biofilms are also more resistant to antibiotics than their isolated confreres, so the new device could have other medical applications. Wound infections, for example, often form biofilms. If they cannot be treated successfully, the result may be gangrene. And if Dr Jiang’s version of St Elmo’s fire can deal with that problem, the saint may become patron of a lot more people than just sailors.

A web of sound

Talk about that

Jun 18th 2009
From The Economist print edition

Websites that use the spoken word will empower the illiterate

THE internet, wonderful though it is, reinforces one of life's fundamental divisions: that between the literate and the illiterate. Most websites, even those heavy with video content, rely on their users being able to read and—if interactive—write. Building your own site certainly does.

Guruduth Banavar, the director of IBM's India Research Laboratory, wanted to allow people who struggle with literacy to create websites. So he and his colleagues have devised a system based on what is known as "voice extensible markup language", a cousin of the hypertext markup language used on conventional websites, that allows a website to be built and operated more or less by voice alone.

The "spoken web" Dr Banavar hopes to conjure into existence will be based on mobile phones, which are already proving an effective alternative to computers for obtaining information online in poor countries. As well as making voice calls, people can text one another and, if their phones are up to the job, get access to the web. Across the developing world there are a number of successful banking and money-transfer services that rely on mobile phones rather than computers.

Dr Banavar, however, thinks mobiles could be made to work much harder. His voice sites are hosted on standard computer servers and behave much like conventional websites. At their most basic they are designed for local use, acting as portals through which people can find out such things as when the mobile hospital will next visit their village, the price of rice in the local market and which wells they should use for irrigation. Instead of typing in a web address, the user rings the website up. Then, with a combination of voice commands and key presses, he navigates through a spoken list of topics and listens to subjects of interest.

That is useful, but not startlingly different from the sort of call-centre hell familiar to anyone who has tried to get information out of a large company by telephone. What makes Dr Banavar's approach different is that, by selecting an appropriate option with the handset, the user can add content to a voice site by recording a comment that is then made available to others. This can then be accessed as one of the "latest additions" or "most listened to" items in a spoken sub-menu. More important still, though, is that people can use a mobile phone to build their own voice sites—a process that, in trials conducted by the laboratory, even a non-expert could learn in as little as ten minutes.

The voice of the people

To build a site the user first selects a suitable template. The system then talks him through the bells and whistles he might wish to add to that template. A carpenter or autorickshaw driver, for example, can advertise his services, receive and confirm offers of work and even undertake basic commercial transactions through such a site. And the site can store offers of work when its owner is unavailable—as often happens in places where several people share a handset.

Like a more conventional website, a voice site has a mechanism by which information can be linked together and browsed, both backwards and forwards. The system IBM employs to achieve this, the hyperspeech transfer protocol (HSTP), is similar in principle to the hypertext transfer protocol that provides links from one conventional website to another. The HSTP allows, for instance, someone listening to an item on a voice site to hear another linked item and then return to the first one and continue listening from where he left off.

India, one of the world's fastest-growing mobile-phone markets, is an obvious place to try all this out. Although more than a third of its population of 1.2 billion now have a handset, they are often basic devices

shared among families and friends. IBM is therefore carrying out trials of the spoken web in several parts of India—and, in collaboration with various other groups, in other countries.

Users will have to make calls, and those calls will cost money. But, Dr Banavar thinks, there are many ways of paying for them. Public-service sites such as local portals might be toll-free and subsidised by governments. Commercial sites could take a small percentage of any transaction carried out over them. Advertising might also provide revenue. It would, after all, be more difficult for the listener to screen out than the visual adverts seen on a conventional site.

Paternity and parental investment

Like father, like son

Jun 18th 2009
From The Economist print edition

There is a benefit in looking like dad

Alamy

You'll be a man, my son

MEN are doomed to uncertainty. Women know who their children are, but the ubiquity of sexual cheating makes it difficult for males of many species, humans included, to be sure which youngsters actually belong to them. If a male's reproductive strategy amounts to little more than "Wham, bam, thank-you ma'am", this may not matter to him much. But if, as in the human case, he takes an interest in his offspring, it matters a lot. There are few more foolish actions, from an evolutionary point of view, than raising another male's progeny.

This line of reasoning led Alexandra Alvergne and her colleagues at the University of Montpellier, in France, to wonder if human fathers recognise features of children that might give away whose offspring they really are, and use those to guide the amount of attention doled out to each putative son and daughter. To find out, they established an experiment among villagers in the Sine Saloum region of Senegal, where polygynous marriages (ie, men with multiple wives) are common. In such societies the incentives for unmarried men and the opportunities for neglected women to engage in what zoologists who study other harem-forming species refer to as "sneaking" are particularly high. It gives the men a chance to reproduce and the women a chance to spread their bets.

Thirty families with at least two children aged between two and seven agreed to participate in a two-part study, in return for gifts of farming equipment and school supplies that were given to the head of their village for appropriate distribution. In the first part, photographs were taken of children and their "fathers". Over 100 judges, selected from distant villages, were then given images of individual children along with images of three adult men. These judges were asked to decide which man was each child's father.

In a second part of the study, the researchers collected T-shirts worn by fathers and their children while sleeping. These T-shirts were presented to 300 judges from other villages who had not participated in the first part of the study. Previous work has shown that parents and offspring can often be paired from the smell of such T-shirts, so the judges were asked to compare the scent of each child's T-shirt with that of two T-shirts worn by men, and identify the shirt that had been worn by the child's father.

During interviews conducted individually with mothers and fathers, Dr Alvergne and her team asked questions about how many hours a day fathers spent with their children. They also asked indirect questions, like whether the father gave the mother money for the children and, if so, how much. Answers were scored numerically, with responses like "he gives me a lot of money each week" getting four points and "he gives me no money" getting zero. Questions associated with marital conflict, drug use and jealousy could generate negative points. The scores were combined to create a paternal-investment index which ranged from a high of +4 to a low of -4. The nutritional condition of all the children in the study was also assessed, in the form of their body-mass indices (BMI), a measure of how much fat their bodies contained.

The result, published in the latest edition of *Animal Behaviour*, is that children who looked and smelled like their fathers did indeed enjoy more paternal care than those who did not. They averaged +1 on the paternal-investment index. The "non-resemblers", those adjudged by outsiders not to smell or look like their fathers, averaged -1. This mattered, for there was also a strong connection between paternal investment and a child's nutritional state. Children whose index was +2 had an average BMI of 16.5. Those whose index was -2 averaged a BMI of 15.

A BMI of 15 is not unhealthy (it is only slightly below the average for a five-year-old American boy). But

16.5 is nicely near the top of the range for a five-year-old, without him tipping into being overweight. Family resemblances, then, do matter. Looks may not kill, but they can leave you feeling peckish.

Art Basel 2009

Recession appeal

Jun 18th 2009 | BASEL
From The Economist print edition

Collectors like nothing better than a good economic downturn

Art Basel

IT IS the world's most important contemporary art fair. Art Basel this year attracted 61,000 collectors, curators and art afficionados—more than ever before. Celebrating its 40th anniversary, the five-day fair which closed on June 14th, drew over 300 galleries from 29 countries, showing works by more than 2,500 artists. To many it must have seemed as if the economic recession was happening elsewhere.

Getting hard numbers on how much business was done was more difficult. "Everything is anecdotal," said Marc Spiegler, the fair's co-director, who admits that he gathers his best market intelligence from informal conversations at the Kunsthalle beer garden. Connoisseurs revel in the art market's illegibility. "Knowledge and effort are rewarded," explains John Smith, an art collector and director of Bain & Company, a management consultancy. "The art market is one of the last bastions of inefficiency and that's what makes it so fascinating."

By all nebulous barometers, business in Basel was satisfactory, possibly even very good. Many dealers reported transactions at around $1m for artists such as Anish Kapoor, Martin Kippenberger, Neo Rauch, Barbara Kruger and even youngsters like Raqib Shaw. Hauser and Wirth sold Christoph Büchel's "Wallet (Lost)", a ready-made sculpture that consists of the artist's wallet containing credit cards, identity documents and a few Swiss francs. It was screwed to the floor of the gallery's stand; the screw and washer were included in the €55,000 ($76,346) sale price. 303 Gallery also did well with the work of Hans-Peter Feldmann. Among other pieces, it sold a large-scale black-and-white photograph of the artist's own bookshelves for €60,000. It was one of a handful of works acquired by Don Marron, the chief executive of Lightyear Capital and a trustee of the Museum of Modern Art in New York. Jeffrey Deitch sold Kehinde Wiley's "Lamentation over the Dead Christ" for a little less than $175,000 to Princess Gloria von Thurn und Taxis, who plans to hang it alongside the Old Masters at her palace in Regensburg.

At the other end of the scale, Michael Werner Gallery sold one of Peter Doig's classic "Concrete Cabin" paintings from the mid-1990s for around $3m. And Larry Gagosian succeeded in selling one of Andy Warhol's 1965 paintings of Campbell's Soup cans for even more than that. The painting was part of a package of Warhol works that he acquired just over a year ago for $200m from the estate of Ileana

Sonnabend, a famed New York dealer.

Art Basel's buoyancy this year has several causes: the return of fervent collectors who prefer to buy in a down market; the swift reaction of dealers willing to lower their prices to ensure a sale (collectors were in a good mood because “$100,000 means something again”); the perception that art is more solid than some other asset classes; and the keenness of many buyers to divert savings out of their Swiss bank accounts.

The fair tends to see bigger crowds and higher sales when, as happened this year, it is preceded by the Venice Biennale. On this occasion there was also the “Dogana- effect”, a reference to the renovated customs house at Punta della Dogana in Venice that houses works from the extensive collection of François Pinault, a French luxury-goods billionaire. The building, whose opening was one of the highlights of the Biennale, raised the bar for private museums and many collectors were reassured by the confident display of new masterpieces by artists such as Maurizio Cattelan, Mike Kelley and Cindy Sherman.

Art Basel is not just a market but a social whirl that thrives on ambience—cocktails at the Beyeler Museum, dinner at Chez Donati, nightcaps at the Three Kings Hotel. No one wants to go home empty-handed and collectors encourage each other to spend. There was much talk about how the speculators of the boom years had vanished. Certainly, decorators and dilettantes were thin on the ground, but many speculators are connoisseurs who relish the prospect of picking up work at lower prices and waiting for the next surge. As one consultant commented: “Anybody buying quality in the next three or four years will feel good about it in the long term.”

For those who were exhausted by the shopping there was always art that was priceless. One of the most talked about events of Art Basel was a group show called “Il Tempo Del Postino”. Curated by Hans Ulrich Obrist and Philippe Parreno, the exhibition, which took up time rather than space, consisted of a theatrical show by 20 artists, including Olafur Eliasson, Tino Sehgal and Anri Sala. Liberating the audience from a focus on objects with prices, it was a joyous occasion.

Liberty and terror

Paying the price

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From The Economist print edition

Liberty in the Age of Terror: A Defence of Civil Society and Enlightenment Values. By A.C. Grayling. *Bloomsbury; 283 pages; £12.99.* Buy from Amazon.co.uk

FIVE years ago, Britain's newly appointed information commissioner, Richard Thomas, gave warning that the public was in danger of "sleepwalking into a surveillance society". Last week, as he prepared to leave office, he claimed that although he had not been able to halt the tidal wave of official intrusion into the private lives of citizens, he did believe that people's eyes were now open and that, consequently, the nation's rulers had become more aware of the need to balance security with liberty. A.C. Grayling is far less sanguine.

In his latest book, the professor of philosophy at London's Birkbeck College deploys all his polemical powers to show that there has been no let-up in the erosion of hard-won civil liberties. Governments say that they are only trying to protect people from the criminal and the wicked in an age when global terrorism poses a serious threat to "our way of life". Mr Grayling argues that the malign coincidence of the so-called "war on terror" with a raft of invasive new technologies (from ubiquitous 24-hour CCTV cameras to the massive extension of electronic eavesdropping and all-encompassing databases) has provided both the excuse and the means for an assault on individual freedoms by democratically elected governments.

This is by no means a new argument. For much of the past decade, in both Britain and America, liberal lawyers, civil- liberties lobbies and campaigning journalists have been sounding the alarm. But a certain shrillness of tone and an unwillingness to take sufficiently seriously the ever-present danger of terrorist atrocities of appalling brutality has lessened their impact. And besides, even now many supposedly sensible people lazily believe that if you have nothing to hide, you have nothing to worry about. If a few Koran-toting chaps with beards and funny names get banged up in Guantánamo or have to put up with a "control order" to stay in Britain, so what?

It is this complacency that Mr Grayling, with passion and elegance, takes on. He describes the if-you-have-nothing-to-hide argument as "one of the most seductive betrayals of liberty" imaginable. The assumption behind it is, he says, "that the authorities will always be benign; will always reliably identify and interfere with genuinely bad people only; will never find themselves engaging in 'mission creep', with more and more uses to put their new powers and capabilities to; will not redefine crimes, nor redefine various behaviours or views now regarded as acceptable, to extend the range of things for which people can be placed under suspicion—and so considerably on."

Mr Grayling accepts that some legislative powers may be necessary to counter specific threats. But these must always be strictly time-limited, in the way that many of the measures were when they were introduced during the second world war (when the dangers really could be described as existential). Nor does he minimise the vileness of Islamist terrorism that seeks to inflict indiscriminate and wanton mass murder. But as freedom without some risk is impossible, it is obvious that people cannot expect politicians to put protecting them from every conceivable danger (something they are anyway powerless to do) before all other duties to society. As Benjamin Franklin observed: "They that can give up essential liberty to obtain a little temporary safety deserve neither liberty nor safety."

Above all, Mr Grayling seeks to uphold the values of the Enlightenment, of which the most important is freedom of speech, the freedom that supports all other freedoms. To that end, he reserves special scorn for the craven willingness of the British government to legislate against causing offence to people with religious sensibilities and the self-censorship of some media organisations in the face of bullying and blackmail. The only thing a tolerant society cannot tolerate is intolerance. Mr Grayling says that people who think differently must either lump it or go and live somewhere else.

This is a timely and invigorating call to arms. But whereas Mr Grayling does not exaggerate the threats to liberty, he makes too little of the growing resistance to them. Nothing could be more satisfying than the

furious response of Dick Cheney to Barack Obama's determination to subject the darkest deeds of the Bush administration to light and scrutiny. In Britain, the law lords have just told the government that the use of secret evidence to obtain control orders on three suspected terrorists breached their human right to a fair trial. A new government is almost certain to scrap the national identity register beloved of Tony Blair and Gordon Brown, while Mr Brown's attempt to secure 42 days' detention without charge for terror suspects has already ended in ignominious failure. The fightback has begun. Mr Grayling's book is the latest reminder of why it must not flag.

Women and jihad

A singular life

Jun 18th 2009
From The Economist print edition

Illustration by Daniel Pudles

The Mother of Mohammed: An Australian Woman's Extraordinary Journey into Jihad. By Sally Neighbour. *Melbourne University Press; 368 pages, A$34.99*

SALLY NEIGHBOUR, an Australian journalist who writes about terrorism, has set herself apart from the herd with her careful studies of the lives of terror suspects.

Her first book, "In the Shadow of Swords", was about the Bali bombers. In her latest work, "The Mother of Mohammed", she focuses on an Australian woman who converted to Islam, moved first to Indonesia and then Afghanistan, was branded a dangerous terrorist by Australian intelligence and had her passport revoked. No charges have been brought against her.

Raised in a broken home, Robyn Mary Hutchinson was a "tenacious tomboy" who railed against conformity. As a teenager, she became a drug-using surfing groupie, and eventually took the hippy trail to Bali. There she converted to Islam, adopted the name Rabiah, married into the Javanese royal family and had two children. Later she left her husband, a drug addict, married again and had more children, before coming into contact with Abu Bakar Bashir, the imam who envisioned an Islamic caliphate across an arc of South-East Asia and whose name has been linked to several terrorist attacks in Indonesia. Eventually, Ms Hutchinson moved to Pakistan, where she seems to have found happiness living a spartan existence among a community of devout Muslims, a veritable United Nations of educated, professional women.

Non-Australian readers may find the early chapters contain too much detail about life Down Under, but the reader becomes drawn in to Ms Hutchinson's story and the book is hard to put down. From Pakistan she moved to Afghanistan, where she became known as Umm Mohammed ("mother of Mohammed", the name of one of her sons) and got to know the leaders of al-Qaeda, including Osama bin Laden. He gave her an air conditioner and may even have proposed marriage.

Ms Hutchinson did not become a Muslim and go to Afghanistan because she wanted to blow up Americans or Jews. She went because she was searching for the perfect Islamic state, something she thought the Taliban might offer her. Ms Neighbour interviewed Ms Hutchinson once or twice a week over a period of 18 months. She found no evidence that she engaged in terrorism; nor, it seems, did the Australian authorities.

Ms Hutchinson escaped from Afghanistan with her children after the American-led invasion in October 2002. She returned to Sydney where she is watched closely by Australia's domestic intelligence agency, and, Ms Neighbour writes, has become "a virtual prisoner in her home". It appears that Ms Hutchinson is being punished for her religious views and her associations.

Richard Haass on Iraq

A good man in Washington

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War of Necessity, War of Choice: A Memoir of Two Iraq Wars. By Richard N. Haass. *Simon & Schuster; 352 pages; $27.* Buy from Amazon.com, Amazon.co.uk

Corbis

RICHARD HAASS is a good man. Thoughtful, intelligent, scholarly and often even wise, he is usually persuasive about foreign policy, both in its formulation and in its execution. He understands that the world is complex and that issues have to be seen in context. But he sees the big picture, too. He can recognise a despot, and the occasions when despotism has to be checked, by force if necessary. Yet he also believes in diplomacy, multilateralism and the United Nations. He is, in short, just the sort of man who should be running America's foreign policy.

How fortunate, then, that Mr Haass was doing just that during the first Gulf war. One or two others were involved in the events that led up to the expulsion of Saddam Hussein from Kuwait in 1991, but Mr Haass, as special assistant to President George Bush senior and director on the staff of the National Security Council, played a pretty big part in this rather successful enterprise. It was, as he correctly saw, a war of necessity, both for America and for the new world order Mr Bush was proclaiming. And Mr Haass was also right to see that necessity stopped well short of Baghdad and the removal of Saddam. The principle at stake was the inviolability of a sovereign state, not the creation of a democracy in the aggressor country.

Mr Haass's next war was different. This was a war of choice, since Saddam was "a nuisance, not a mortal threat", who should simply have been contained. Again Mr Haass was right. So what was he doing as director of policy planning in the State Department and working as a principal adviser to the secretary of state, Colin Powell? He was critical of the war on terrorism, the administration's policies on Afghanistan, Israel-Palestine, Iran, North Korea, the Kyoto protocol and the International Criminal Court. He was shocked not just by Dick Cheney's views but also by the way the vice-president could make public speeches whose fantastical claims about Saddam's imminent acquisition of nuclear weapons had been given no vetting by the CIA or the National Security Council. He saw how the White House cynically used the popularity of his boss, Mr Powell, while being wildly jealous of it. He saw the creation of policy-based evidence. Above all, he was from the outset opposed to regime change in Iraq. Yet he did not resign.

The second part of this book changes from being a how-I-won-the-war memoir to being a nobody-would-listen-to-me tale. The trouble is that the brave voice of dissent who was "not shy" of pushing his own views in the first, good war becomes a largely mute Cassandra in the second, bad war. He does tell his boss of his misgivings (and now publishes a cautionary 2002 memo about post-war Iraq), but Mr Powell and the entire State Department are isolated. Eventually, at the start of 2003—the war began on March 19th—he decides he must act. But his "last-ditch effort" is simply "at slowing things down", and this bold venture takes the form of typing another memo to his boss. This Mr Powell reads and tucks in his pocket, where it may still be today.

In truth, wise and prescient though he often seemed, Mr Haass was only "60/40 against going to war". It took some unconnected gibes, notably his wife's comment that he had become an "enabler", to make him see that he was being used, and in July 2003 he slipped away from the administration. His book will be of some interest to students of the Washington bureaucracy, but of much more to those who worry about when public servants should resign. It is a tale of a good man doggedly working for a bad end, an end that was not simply a war of choice, or a preventive war of dubious legality, but a war of revenge. Not a great paragraph in the CV.

Economist.com BOOKS & ARTS

Britain's roads

Motor ways and wherefores

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On Roads: A Hidden History. By Joe Moran. *Profile Books; 288 pages; £14.99.* Buy from Amazon.com, Amazon.co.uk

EVERY industry is susceptible to fads, even publishing. Quirky histories have had a long run. Cod, quinine, redheads, potatoes—even gerbils—have all had a book or two devoted to them. In theory, the offbeat subject matter provides an unusual angle from which to examine things with a wider appeal (the potato book, for instance, ventures into global migration patterns, social reform and high finance). But it can be a tricky formula to get right.

Happily Joe Moran's history of Britain's roads mostly manages to pull it off. The book is a ramble through the place of roads in British culture. Its approach is broadly linear, from the building of the first motorways in the 1950s to the anti-road protests of the 1990s and the paralysis of today. There are amusing diversions along the way: musings on the spiritual significance of motorway service stations to itinerant rock bands and the interesting observation that homing pigeons often follow man-made roads to their destinations.

The nearest the book comes to a central thesis is charting the creeping disenchantment with modernity that characterised the second half of the 20th century. Cars and roads have always had detractors (Mr Moran quotes G.K. Chesterton praising Britain's "splendid parochialisms" and complaining about "motor-car civilisation…roaring on at last to the capture of the solar system"). But for most of the 20th century, most people saw roads as heralds of a shinier, happier future. There was much angst in the 1930s, for instance, about the speed with which fascist Italy and Germany were building them, leaving muddled, democratic Britain in the dust.

After the war had reassured Britons that perhaps democracy wasn't so bad after all, the enthusiasm increased. Reporting on the opening of the M1, the motorway that links London with Yorkshire, one newspaper confessed to feeling "sentiments too deep for tears". Others reported breathlessly on the ease with which they were suddenly able to zoom about the country (these being the days before speed limits, one reporter claimed to have driven the new road at 157mph in an Aston Martin).

But enthusiasm soon turned to hatred. The first road protests popped up in the 1970s. By the 1990s they were media events, with protesters camped in tree-houses or warrens inspired by the tunnels of the Viet Cong. Some were muddled Luddites, others were angry locals whose houses were slated for demolition. But, as Mr Moran points out, much of the anger was directed at technocrats whose promises have spectacularly failed to come true. When elevated motorways were being built, their architects promised that people could be housed in flats carved out of the support stanchions. The areas beneath would become parks, greening the city by banishing its traffic into the sky. But it never happened that way. Half a century later, when one member of parliament suggested housing disruptive families in vandalism-proof steel containers tucked away "beneath the motorway flyover", the roadways' fall from grace was complete.

Mr Moran tries hard to avoid taking sides, although the reader may suspect that his sympathies may lie more with the protesters than the road-builders. His even-handedness, though fair, occasionally becomes frustrating. There is a discussion at the end of the book about what the correct road-building policy should be. Mr Moran lists the problems of every approach: naively building roads simply creates more traffic, while forcing people to pay for them is politically almost impossible. But he offers no solutions of his own.

Nevertheless, this is a pleasant book. Read it before a long journey, and you may regard the boring old motorway with a new appreciation.

"Phèdre" at the National Theatre

A world first

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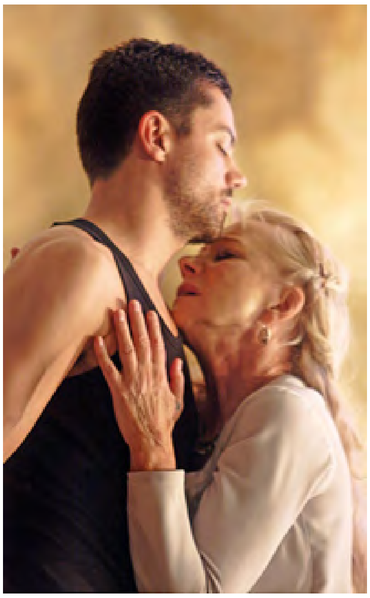
From The Economist print edition

More people are likely to see the National Theatre's "Phèdre" on June 25th than have ever seen a single live production of a play before

Catherine Ashmore



Helen rules the heart

"PHEDRE" is an everyday story of an ancient Greek royal family. A queen, thinking her husband Theseus is dead, reveals her incestuous love for her stepson, Hippolytus, who prefers the love of a young woman. But Theseus returns and Phèdre tries to protect her reputation by suggesting that Hippolytus has raped her.

The drama ends in the deaths of Hippolytus and Phèdre. This is not easy to absorb in a single instalment, especially as it was written in iambic pentameters in 1677 by a French playwright, Jean Racine, and is played in two hours without an interval. Even when performed in a version by such a fine English poet as Ted Hughes, the play sounds only slightly less forbidding.

Nonetheless, on June 25th the National Theatre's production of "Phèdre" is very likely to draw the largest-ever audience for a single performance of a play. That evening's show is being transmitted live by satellite to 68 screens in Britain, as well as 20 more in Europe, and it will be shown, after a five-hour time delay, in 33 cinemas in America. An audience of 20,000 or so is expected to watch it. (Theatre-goers in the southern hemisphere will see it in July when it will be shown in parts that Greek drama rarely reaches, such as Wagga Wagga in rural New South Wales.)

Nicholas Hytner, director of the National Theatre and of "Phèdre", cannot think of a play that has reached a larger audience. The great amphitheatre at Epidaurus, south-west of Athens, where Euripides's original version of "Phèdre" would surely have played in the 3rd century BC, and which this production will visit on July 10th and 11th, holds a mere 12,000 or so.

The production opened earlier this month to generally excellent reviews. The lead is played by a British film star, Helen Mirren, the cast is uniformly excellent and Mr Hytner's work is first rate, as is Bob Crowley's set. It is very promising, but to encourage the thousands to come back for more, it has to be good.

The transmission from the Lyttelton theatre on the south bank of the Thames can be received in cinemas that have a digital projector and a satellite dish. The technology is thoroughly tested, and has been proved successful by the Metropolitan Opera in New York, and by Covent Garden and Glyndebourne in England. The Met's operatic repertoire now reaches more than 850 screens in 30 countries. But opera is performed in a universal language. To draw a real crowd for a Greek tragedy is a more ambitious project.

It will go out live. Mr Hytner decided that the cinema audience must feel that it is in a theatre watching a performance that is ephemeral, happening now, and then gone for ever. On the night, the lights will be adjusted in the theatre and the cameras given pride of place, but the director insists that he is not making a film: "I think we'll be getting a theatre audience," he says. Many of the cinemas are art houses, which have been helped to convert to digital projectors by the British Film Council. Despite the size of the audience, the transmission will be shown at a loss and the Arts Council is subsidising the innovation.

Mr Hytner's cast is led by Ms Mirren, a compelling stage actress who has taken to the cinema like a queen to her throne. She originally suggested to Mr Hytner that she play "Phèdre" at the National. When Mr Hytner decided a year ago that the theatre should follow opera into live transmissions, he thought the presence of a film star could only help to make a splash. The idea needs a strong start because this is only the beginning. Further transmissions are planned in the autumn and winter, and they include plays by Shakespeare and Alan Bennett.

Economist.com PEOPLE OBITUARY

Omar Bongo

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Omar Bongo Ondimba, president of Gabon, died on June 8th, aged 73

Rex Features

ON THE Atlantic coast of Gabon, white sand beaches slope out into the ocean. That sand, in which few tourists leave their footprints, was Omar Bongo's. Elephants and buffalo stroll down to the water, and leatherback turtles make their nests: his elephants, his buffalo, his turtles. Oil rigs and gas flares punctuate the horizon: his oil, 3.2 billion barrels in proven reserves. Eastwards, the silver carriages of the world's most expensive railway rattle five times a week through his hardwood forests between Libreville, the capital, and Franceville, in his homeland, carrying loads of his manganese or piled high with his *okoumé* and *ozigo* logs, bound mostly for China.

Mr Bongo made no distinction between Gabon and his private property. He had ruled there so long, 42 years, that they had become one. It was therefore perfectly natural that an oil company, granted a large concession for coastal drilling, should slip him regular suitcases stuffed with cash. It was natural that $2.6m in aid money should be used to decorate his private jet, that government funds should pay for the Italian marble cladding his palace, and that his wife Edith's sea-blue Maybach, in which she was driven round Paris, should be paid for with a cheque drawn on the Gabonese treasury. Of the $130m in his personal accounts at Citibank in New York, it was probable—though Citibank never asked, and nobody ever managed to pin a charge on him—that much of it was derived from the GDP of his country.

The suggestion of fiddling public finances flummoxed and infuriated him. Corruption, he once explained to a reporter, was not an African word. No more was nepotism: he simply looked after his family, supplying them with villas in Nice as well as the ministries of defence and foreign affairs. When French judges in 2009 froze nine of his 70 bank accounts, he was outraged. An attack on him was obviously an attempt to destabilise his country. He was equally indignant when in 2004, after a "Miss Humanity" pageant was held in Libreville, Miss Peru charged him with sexual harassment for summoning her to the palace and, he hoped, to his nifty behind-the-panelling bed. If something was in Gabon, by nature or chance, he

évidemment had first dibs on it.

France, the ex-colonial power in Gabon, went along with this. Mr Bongo, though short, was every inch a Francophile, from his platform heels through the immaculate tailoring to his gravelly-but-grammatical French. Their bargain, too, was a neat one. He allowed the French to take his oil and wood; they subsidised and protected him. At various times through his long political career, when opposition elements got brash or multi-party democracy, which he allowed after 1993, became too lively, the French military base in Libreville would turn out the paratroopers for him. In France, to which he went as often as he could, he had his choice of 39 properties, four of them on the Avenue Foch in Paris, in which to hobnob with the cream of the Elysée. Swanning round as he did, paying for everything with crisp wads of notes, he naturally funnelled money to French politicians, right or left, who caught his eye. When Valéry Giscard d'Estaing complained about Gabonese funding of his rival, Jacques Chirac, Mr Bongo once again failed to grasp what he objected to.

Dirt roads and champagne

At home, since Gabon was his, he cosseted it one moment and ravaged it the next. In 2002 he created 13 national parks, but the trees and even the waterfalls could go for a consideration. His lordly airs were impressive for a farmer's son from Lewai (now Bongoville), the youngest of at least nine children, born "without a cot or a nanny", as he boasted on his website, and whose expectations under French rule had extended no further than working in the post office. Usefulness and scheming got him right to the top, to become President Léon M'ba's right-hand man and, when M'ba died in 1967, president himself; as well as minister of defence, interior, information and planning.

Gabon's riches eased his way at every turn. A timber concession here, a stretch of paved road or a Bongo stadium there, disarmed anyone who objected to his way of doing things. Even Pierre Mamboundou, his most diligent opponent, was soothed after many years with $21.5m spent on his constituency. Business visitors to the capital found it chic, feudal and hospitable, like an Arab emirate; in Mr Bongo's time, Gabon's consumption of champagne was said to be the highest in the world. Everyone could be suborned or sweetened except his first wife, Joséphine, who became a pop singer after the divorce and sang cutting songs about her young replacement.

Outside the glamour of Libreville, where the M'bolo *hypermarché* offered shining shelves of fine wines and best French cheese, a third of his people travelled on back-breaking roads between villages without clinics, subsisting on cassava and fishing. But Mr Bongo brought decades of tranquillity, a rare enough commodity in Central Africa; order, and prosperity for a close and favoured few. So on June 11th hundreds of Gabonese lined up, clutching his portrait, outside the presidential palace where, in a flower-filled chapel, he lay in state, rather small in his coffin, in the country that was his.

Overview

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America's current-account deficit narrowed from $155 billion to $101.5 billion in the first quarter. This was equivalent to 2.9% of GDP, the lowest proportion for a decade. Industrial production in America fell by 1.1% in May, following a 0.7% drop in April. There was brighter news from the housing market. The number of new housing starts jumped by 17.2% in May. The number of permits to build new private homes also rose.

Inflation continued to decline in many countries. Consumer prices in America fell by 1.3% in the year to May, after falling by 0.7% in the year to April. In the euro area prices were flat in the year to May, having increased by 0.6% in the year to April. Inflation in Britain has dropped less quickly than had been expected. Prices rose by 2.2% in the year to May, slightly below the rate in April. Inflation is also receding in emerging markets. In Poland, it fell from 4% to 3.6%.

Britain's **unemployment** rate rose to 7.2% in the three months to April from 6.5% in the previous quarter. The number claiming unemployment benefits more than doubled in the 12 months to May to 1.54m, the highest level since 1997.

The **Bank of Japan** voted unanimously on June 16th to leave its benchmark interest rate at 0.1%, where it has stood since December. Norway's central bank cut its key interest rate by 0.25 percentage points to a record low of 1.25%. The minutes from the Reserve Bank of Australia's June meeting suggested the bank would cut interest rates from 3% if the economy deteriorated.

Output, prices and jobs

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Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2009†	2010†	latest	latest	year ago	2009†	rate‡, %
United States	−2.5 Q1	−5.7	−2.8	+1.6	−13.4 May	−1.3 May	+4.2	−0.8	9.4 May
Japan	−8.8 Q1	−14.2	−6.7	+0.8	−30.7 Apr	−0.1 Apr	+0.8	−1.1	5.0 Apr
China	+6.1 Q1	na	+6.5	+7.3	+8.9 May	−1.4 May	+7.7	−0.5	9.0 2008
Britain	−4.1 Q1	−7.4	−3.7	+0.6	−12.3 Apr	+2.2 May§	+3.3	+1.5	7.2 Apr††
Canada	−2.1 Q1	−5.4	−2.3	+1.7	−8.4 Mar	+0.4 Apr	+1.7	+0.3	8.4 May
Euro area	−4.8 Q1	−9.7	−4.1	+0.5	−21.6 Apr	nil May	+3.7	+0.4	9.2 Apr
Austria	−3.5 Q1	−10.6	−2.6	+0.2	−14.3 Mar	+0.3 May	+3.7	+0.5	4.2 Apr
Belgium	−3.0 Q1	−6.2	−3.3	+0.2	−11.5 Mar	−0.4 May	+5.2	+0.5	11.2 Feb‡‡
France	−3.2 Q1	−4.7	−2.8	+0.5	−18.8 Apr	−0.3 May	+3.3	+0.2	8.9 Apr
Germany	−6.9 Q1	−14.4	−5.5	+0.5	−21.6 Apr	nil May	+3.0	+0.2	8.3 Apr
Greece	+0.3 Q1	−4.6	−3.1	−0.7	−11.7 Apr	+0.5 May	+4.9	+0.4	9.2 Mar
Italy	−6.0 Q1	−10.1	−4.4	+0.3	−24.2 Apr	+0.9 May	+3.6	+0.7	6.9 Q4
Netherlands	−4.5 Q1	−10.7	−3.9	+0.5	−13.2 Apr	+1.6 May	+2.3	+0.9	4.5 May††
Spain	−3.0 Q1	−7.4	−3.5	−0.5	−28.6 Apr	−0.9 May	+4.6	−0.1	18.1 Apr
Czech Republic	−3.4 Q1	−12.9	−3.0	+1.2	−23.2 Apr	+1.3 May	+6.8	+1.9	7.9 May
Denmark	−3.7 Q4	−7.3	−3.5	+0.5	−15.0 Apr†††	+1.3 May	+3.4	+1.0	3.3 Apr
Hungary	−6.7 Q1	−9.6	−6.0	−1.0	−25.3 Apr	+3.8 May	+7.0	+3.3	9.9 Apr††
Norway	+1.5 Q1	−1.8	−2.0	+0.5	−4.0 Apr	+3.0 May	+3.1	+2.0	3.2 Mar***
Poland	+0.8 Q1	na	−0.8	+1.5	−12.4 Apr	+3.6 May	+4.4	+2.5	11.0 Apr††
Russia	−9.5 Q1	na	−5.0	+2.0	−17.1 May	+12.3 May	+15.1	+13.6	10.2 Apr‡‡
Sweden	−6.5 Q1	−3.6	−4.6	+0.9	−21.2 Apr	−0.4 May	+4.0	−0.4	9.0 May‡‡
Switzerland	−2.4 Q1	−16.0	−2.3	+0.3	−9.4 Q1	−1.0 May	+2.9	−0.5	3.5 May
Turkey	−6.2 Q4	na	−4.5	+1.2	−18.5 Apr	+5.2 May	+10.7	+6.2	16.1 Q1‡‡
Australia	+0.4 Q1	+1.5	−0.8	+1.6	−0.7 Q4	+2.5 Q1	+4.2	+1.8	5.7 May
Hong Kong	−7.8 Q1	−16.1	−6.7	+0.9	−10.2 Q1	+0.6 Apr	+5.4	+1.0	5.3 May††
India	+5.8 Q1	na	+5.0	+6.4	+1.4 Apr	+8.7 Apr	+7.8	+5.0	6.8 2008
Indonesia	+4.4 Q1	na	+2.4	+3.2	+1.6 Mar	+3.8 May	+10.4	+3.9	8.4 Aug
Malaysia	−6.2 Q1	na	−3.0	+1.2	−11.5 Apr	+3.0 Apr	+3.0	−0.4	3.0 Q4
Pakistan	+5.8 2008**	na	−0.9	+2.0	−20.6 Mar	+14.4 May	+19.3	+12.6	5.6 2007
Singapore	−10.1 Q1	−14.6	−8.8	+1.0	−0.5 Apr	−0.7 Apr	+7.5	−0.2	3.3 Q1
South Korea	−4.2 Q1	+0.5	−5.0	+0.6	−8.2 Apr	+2.7 May	+4.9	+1.6	3.9 May
Taiwan	−10.2 Q1	na	−6.9	+0.5	−19.5 Apr	−0.1 May	+3.7	−1.3	5.8 Apr
Thailand	−7.1 Q1	−7.3	−4.5	+1.9	−9.7 Apr	−3.3 May	+7.6	−1.0	1.9 Mar
Argentina	+4.9 Q4	−1.2	−3.5	+0.5	−1.2 Apr	+5.5 May	+9.1	+7.0	8.4 Q1‡‡
Brazil	−1.8 Q1	−3.3	−1.5	+2.7	−14.8 Apr	+5.2 May	+5.6	+4.7	8.9 Apr‡‡
Chile	−2.1 Q1	−2.4	−1.0	+2.0	−11.1 Apr	+3.0 May	+8.9	+2.4	9.8 Apr††‡‡
Colombia	−0.7 Q4	−4.1	−2.0	+1.8	+0.4 Mar	+4.8 May	+6.4	+5.2	12.0 Mar‡‡
Mexico	−8.2 Q1	−21.5	−7.1	+2.8	−13.2 Apr	+6.0 May	+4.9	+5.5	5.3 Apr‡‡
Venezuela	+0.3 Q1	na	−5.5	−5.4	−0.9 Jan	+27.7 May	+31.4	+30.3	8.1 Q1‡‡
Egypt	+4.3 Q1	na	+3.4	+3.1	+5.7 Q4	+10.2 May	+19.7	+9.1	9.4 Q1‡‡
Israel	+0.5 Q1	−3.6	−0.9	+2.0	−7.7 Mar	+2.8 May	+5.4	+1.5	7.6 Q1
Saudi Arabia	+4.2 2008	na	−1.0	+3.3	na	+5.2 Apr	+9.2	+4.3	na
South Africa	−1.3 Q1	−6.4	−1.8	+3.1	+8.5 Mar	+8.4 Apr	+11.1	+6.6	23.5 Mar‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	−15.1 Q1	na	−10.0	−2.5	−33.7 Apr	−0.3 May	+11.3	+0.4	11.1 Mar
Finland	−7.6 Q1	−10.3	−5.7	−1.1	−21.0 Apr	nil May	+4.2	+0.3	8.2 Apr
Iceland	−3.9 Q1	−13.6	−12.1	−0.7	+10.1 2008	+11.6 May	+12.3	+12.5	9.1 Apr‡‡
Ireland	−7.5 Q4	−25.7	−7.5	−2.8	−6.7 Mar	−3.5 Apr	+4.3	−3.5	11.8 May
Latvia	−18.0 Q1	na	−17.0	−4.0	−16.9 Apr	+4.7 May	+17.9	+2.5	16.1 Mar
Lithuania	−13.6 Q1	−35.8	−13.0	−4.5	−25.5 Apr	+5.2 May	+12.0	+5.0	8.7 Apr‡‡
Luxembourg	−5.2 Q4	−16.8	−5.0	−0.9	−36.1 Feb	−0.3 May	+4.0	+0.5	5.5 Apr‡‡
New Zealand	−2.3 Q4	−2.3	−2.7	+0.6	−7.2 Q4	+3.0 Q1	+3.4	+1.4	5.0 Q1
Peru	+3.0 Mar	na	+1.3	+2.5	−7.4 Feb	+4.2 May	+5.4	+4.1	9.3 Mar‡‡
Philippines	+0.4 Q1	−8.9	−1.8	+2.3	−12.7 Mar	+3.3 May	+9.5	+2.9	7.5 Q2‡‡
Portugal	−3.7 Q1	−6.2	−4.1	−0.3	−9.9 Apr	−1.2 May	+2.8	−0.7	8.9 Q1‡‡
Slovakia	−5.6 Q1	na	−4.0	+0.7	−24.8 Apr	+2.2 May	+4.6	+1.5	10.9 Apr‡‡
Slovenia	−8.5 Q1	na	−4.0	+0.5	−24.9 Apr	+0.7 May	+6.4	+1.2	8.4 Mar‡‡
Ukraine	+6.9 Q3	na	−10.0	+1.0	−31.8 May	+14.7 May	+31.1	+16.5	2.9 Apr
Vietnam	+5.5 Q4	na	+2.1	+4.9	+5.4 Apr	+9.2 Apr	+21.4	+6.0	4.6 2007

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions. §RPI inflation rate -1.1 in May. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. ***Centred 3-month average †††New series

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

Jun 18th 2009
From The Economist print edition

The Economist commodity-price index
2000=100

	Jun 9th	Jun 16th*	% change on one month	% change on one year
Dollar index				
All items	190.9	186.2	+2.4	-30.5
Food	216.6	208.0	nil	-25.2
Industrials				
All	157.7	157.9	+6.8	-37.9
Nfa†	130.6	129.3	+0.1	-38.4
Metals	172.5	173.5	+9.7	-37.8
Sterling index				
All items	177.9	171.7	-3.4	-17.4
Euro index				
All items	126.1	123.9	+0.3	-22.4
Gold				
$ per oz	951.05	928.35	+0.2	+5.4
West Texas Intermediate				
$ per barrel	69.96	70.47	+18.4	-47.3

*Provisional †Non-food agriculturals

Unemployment

Jun 18th 2009
From The Economist print edition

The world economy's deepest post-war slump has resulted in higher rates of unemployment in many countries. Spain's jobless rate has increased by more than 8 percentage points in the past 12 months, much of it attributable to a collapse in the construction industry. At 18.1% Spain's unemployment rate is now the highest in the rich world. The situation is also dire in Russia, where a 4.2 percentage-point rise in the unemployment rate over the past year has left more than one in ten out of work. America's jobless rate has risen by almost 4 percentage points. The increase in unemployment has been modest so far in Germany, where it is costly to fire workers. In Argentina the jobless rate is unchanged from a year ago.

Trade, exchange rates, budget balances and interest rates

Jun 18th 2009
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2009†	Currency units, per $ Jun 17th	Currency units, per $ year ago	Budget balance % of GDP 2009†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	-711.0 Apr	-628.3 Q1	-3.2	-	-	-13.2	0.36	3.64
Japan	+6.0 Apr	+111.1 Apr	+1.7	95.7	108	-6.8	0.44	1.46
China	+293.9 May	+426.1 Q4	+7.4	6.84	6.88	-3.8	1.23	3.36
Britain	-150.6 Apr	-44.6 Q4	-1.6	0.61	0.51	-13.8	1.20	3.78
Canada	+28.0 Apr	-3.9 Q1	-1.9	1.14	1.02	-2.3	0.23	3.52
Euro area	-54.7 Apr	-145.2 Mar	-1.0	0.72	0.64	-5.8	1.26	3.53
Austria	-4.2 Mar	+15.0 Q4	+1.7	0.72	0.64	-4.6	1.25	4.28
Belgium	+5.0 Feb	-12.1 Dec	-1.8	0.72	0.64	-4.8	1.27	4.07
France	-78.6 Apr	-63.5 Apr	-2.2	0.72	0.64	-6.6	1.25	3.83
Germany	+205.8 Apr	+178.3 Apr	+4.4	0.72	0.64	-4.6	1.25	3.48
Greece	-58.8 Mar	-46.7 Mar	-8.8	0.72	0.64	-6.0	1.25	5.25
Italy	-13.7 Apr	-70.6 Mar	-2.6	0.72	0.64	-5.2	1.25	4.58
Netherlands	+44.8 Apr	+65.3 Q4	+5.9	0.72	0.64	-4.1	1.25	3.91
Spain	-117.2 Mar	-135.9 Mar	-7.5	0.72	0.64	-9.6	1.25	4.21
Czech Republic	+4.1 Apr	-6.3 Apr	-2.0	19.2	15.5	-4.0	2.14	5.73
Denmark	+7.0 Mar	+7.5 Apr	+1.0	5.37	4.81	-2.5	2.40	3.94
Hungary	+0.6 Apr	-13.0 Q4	-2.9	203	157	-3.9	9.65	10.16
Norway	+65.1 May	+79.6 Q1	+12.5	6.43	5.18	7.2	2.15	4.25
Poland	-18.2 Apr	-19.3 Apr	-5.7	3.26	2.18	-4.0	4.62	6.35
Russia	+142.3 Apr	+75.4 Q1	-0.6	31.3	23.6	-8.4	11.50	10.57
Sweden	+13.1 Apr	+31.4 Q1	+7.3	7.92	6.05	-4.7	0.35	3.50
Switzerland	+18.0 Apr	+53.3 Q4	+7.6	1.09	1.04	-3.1	0.40	2.36
Turkey	-54.2 Apr	-26.7 Apr	-0.7	1.57	1.23	-5.6	10.91	6.65‡
Australia	+6.1 Apr	-29.8 Q1	-4.7	1.27	1.06	-4.2	3.26	5.48
Hong Kong	-23.8 Apr	+30.5 Q4	+7.7	7.75	7.81	-4.1	0.33	2.64
India	-104.9 Apr	-37.5 Q4	-3.0	48.1	42.9	-7.7	3.35	7.34
Indonesia	+10.4 Apr	-0.8 Q1	+0.5	10,215	9,285	-3.2	7.61	7.65‡
Malaysia	+41.7 Apr	+39.1 Q4	+12.3	3.53	3.26	-7.8	2.09	2.92‡
Pakistan	-17.0 May	-15.3 Q4	-1.2	81.0	67.0	-5.6	13.00	15.11†
Singapore	+17.1 Apr	+23.1 Q1	+17.2	1.46	1.37	-4.1	0.48	2.47
South Korea	+7.5 May	+13.2 Apr	+2.9	1,260	1,029	-5.7	2.41	5.24
Taiwan	+12.3 May	+29.2 Q1	+9.6	32.9	30.3	-5.0	0.85	1.44
Thailand	+9.9 Apr	+7.9 Apr	+5.3	34.2	33.3	-4.7	1.35	3.39
Argentina	+14.4 Apr	+7.6 Q4	+2.0	3.77	3.02	-1.2	14.63	na
Brazil	+25.6 May	-19.8 Apr	-1.3	2.00	1.62	-2.0	9.16	6.16‡
Chile	+4.0 May	-4.3 Q1	-1.4	550	492	-3.3	1.32	3.02‡
Colombia	+0.1 Mar	-6.8 Q4	-3.9	2,084	1,651	-3.4	5.46	6.27‡
Mexico	-16.2 Apr	-14.2 Q1	-3.5	13.5	10.3	-5.3	5.01	8.19
Venezuela	+32.5 Q1	+26.2 Q1	nil	6.57	3.43§	-7.8	15.98	6.55‡
Egypt	-26.8 Q4	-1.3 Q4	-0.8	5.60	5.34	-7.0	10.29	3.21‡
Israel	-10.2 May	+4.1 Q1	+2.0	3.96	3.36	-5.8	0.37	4.27
Saudi Arabia	+197.4 2008	+124.0 2008	-8.4	3.75	3.75	-9.0	0.65	na
South Africa	-6.2 Apr	-21.0 Q4	-5.6	8.14	8.06	-4.0	7.38	8.80
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	-2.7 Apr	-1.0 Apr	-3.0	11.3	10.1	-3.5	6.00	na
Finland	+7.5 Mar	+3.4 Apr	+0.6	0.72	0.64	-2.6	1.27	3.92
Iceland	+0.3 May	-6.1 Q1	+3.6	128	81.4	-12.0	7.88	na
Ireland	+45.9 Mar	-12.7 Q4	-2.2	0.72	0.64	-12.6	1.25	5.44
Latvia	-4.6 Apr	-2.3 Apr	-2.0	0.50	0.45	-8.0	18.17	na
Lithuania	-4.8 Apr	-3.0 Apr	-1.8	2.49	2.23	-4.8	8.14	na
Luxembourg	-7.5 Mar	+3.0 Q4	na	0.72	0.64	-3.7	1.25	na
New Zealand	-2.9 Apr	-11.3 Q4	-6.1	1.59	1.32	-6.7	3.80	5.91
Peru	+1.8 Apr	-3.8 Q1	-5.5	3.00	2.88	-1.6	3.00	na
Philippines	-7.2 Mar	+4.2 Dec	+2.7	48.3	44.3	-2.9	3.94	na
Portugal	-31.6 Mar	-27.0 Mar	-9.9	0.72	0.64	-6.0	1.25	4.43
Slovakia	-0.1 Apr	-6.0 Mar	-7.0	21.7	19.5	-5.1	1.35	4.91
Slovenia	-3.8 Apr	-2.4 Mar	-2.5	0.72	0.64	-4.7	1.25	na
Ukraine	-13.4 Q1	-9.8 Q1	-0.3	7.63	4.71	-4.3	9.65	na
Vietnam	-5.4 May	-7.0 2007	-10.2	17,773	16,617	-8.8	7.86	7.07

*Merchandise trade only. †The Economist poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.

Markets

Jun 18th 2009
From The Economist print edition

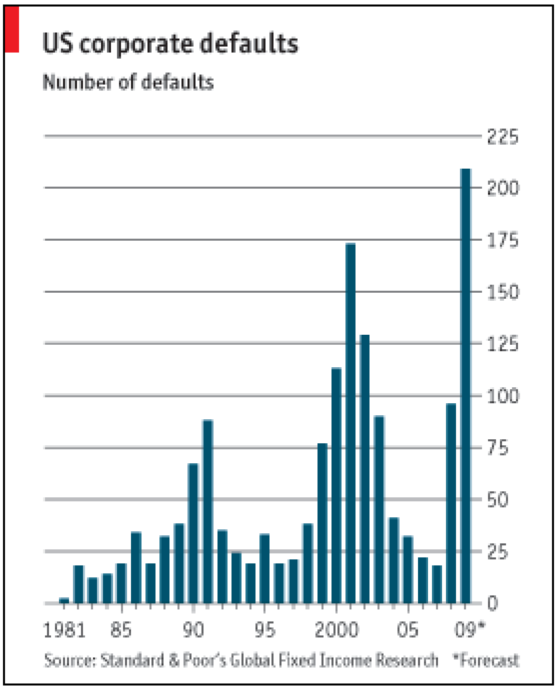
Markets

	Index Jun 17th	% change on: one week	% change on Dec 31st 2008: in local currency	% change on Dec 31st 2008: in $ terms
United States (DJIA)	8,497.2	-2.8	-3.2	-3.2
United States (S&P 500)	910.7	-3.0	+0.8	+0.8
United States (NAScomp)	1,808.1	-2.4	+14.6	+14.6
Japan (Nikkei 225)	9,840.9	-1.5	+11.1	+5.2
Japan (Topix)	923.0	-1.5	+7.4	+1.8
China (SSEA)	2,949.7	-0.2	+54.3	+54.0
China (SSEB, $ terms)	183.9	nil	+66.2	+65.8
Britain (FTSE 100)	4,278.5	-3.6	-3.5	+9.3
Canada (S&P TSX)	10,066.1	-5.0	+12.0	+21.0
Euro area (FTSE Euro 100)	734.0	-4.9	-1.7	-1.9
Euro area (DJ STOXX 50)	2,383.7	-4.7	-2.6	-2.9
Austria (ATX)	2,020.7	-7.7	+15.4	+15.1
Belgium (Bel 20)	1,964.6	-4.8	+2.9	+2.7
France (CAC 40)	3,161.1	-4.6	-1.8	-2.0
Germany (DAX)*	4,800.0	-5.0	-0.2	-0.5
Greece (Athex Comp)	2,162.3	-9.0	+21.0	+20.7
Italy (S&P/MIB)	19,023.1	-6.3	-2.2	-2.5
Netherlands (AEX)	251.2	-5.9	+2.2	+1.9
Spain (Madrid SE)	963.5	-3.3	-1.3	-1.5
Czech Republic (PX)	922.2	-4.8	+7.5	+7.9
Denmark (OMXCB)	269.4	-3.3	+19.1	+18.8
Hungary (BUX)	15,275.2	-8.0	+24.8	+17.3
Norway (OSEAX)	337.1	-5.3	+24.8	+35.9
Poland (WIG)	31,125.9	-2.5	+14.3	+3.8
Russia (RTS, $ terms)	1,038.4	-7.4	+68.3	+64.3
Sweden (OMXS30)†	774.0	-1.7	+16.9	+16.7
Switzerland (SMI)	5,302.3	-2.5	-4.2	-6.1
Turkey (ISE)	34,595.4	+0.6	+28.8	+26.9
Australia (All Ord.)	3,904.2	-2.8	+6.7	+20.0
Hong Kong (Hang Seng)	18,084.6	-3.7	+25.7	+25.7
India (BSE)	14,522.8	-6.1	+50.5	+52.4
Indonesia (JSX)	2,025.0	-4.0	+49.4	+59.4
Malaysia (KLSE)	1,070.9	-1.1	+22.1	+19.6
Pakistan (KSE)	7,075.9	+0.4	+20.6	+17.9
Singapore (STI)	2,271.5	-5.0	+28.9	+27.4
South Korea (KOSPI)	1,391.2	-1.7	+23.7	+23.7
Taiwan (TWI)	6,195.9	-4.1	+35.0	+34.7
Thailand (SET)	586.1	-6.2	+30.3	+32.6
Argentina (MERV)	1,534.6	-7.3	+42.1	+30.3
Brazil (BVSP)	51,045.0	-4.4	+35.9	+58.8
Chile (IGPA)	14,863.0	-3.5	+31.3	+51.9
Colombia (IGBC)	9,599.7	+1.6	+27.0	+37.0
Mexico (IPC)	24,150.9	-4.1	+7.9	+10.8
Venezuela (IBC)	43,554.4	+0.9	+24.1	+33.6
Egypt (Case 30)	6,306.8	+1.6	+37.2	+35.0
Israel (TA-100)	773.1	-5.5	+37.1	+30.8
Saudi Arabia (Tadawul)	5,990.3	+0.8	+24.7	+24.8
South Africa (JSE AS)	21,948.7	-5.7	+2.0	+16.0
Europe (FTSEurofirst 300)	845.8	-3.9	+1.7	+1.4
World, dev'd (MSCI)	952.4	-3.6	+3.5	+3.5
Emerging markets (MSCI)	749.0	-5.1	+32.1	+32.1
World, all (MSCI)	241.8	-3.7	+6.2	+6.2
World bonds (Citigroup)	789.2	+1.0	-2.6	-2.6
EMBI+ (JPMorgan)	435.4	-0.6	+11.2	+11.2
Hedge funds (HFRX)§	1,079.6	+0.5	+5.8	+5.8
Volatility, US (VIX)	31.5	28.5	40.0	(levels)
CDSs, Eur (iTRAXX)‡	134.4	+13.5	-33.5	-33.7
CDSs, N Am (CDX)‡	192.1	+10.3	-17.7	-17.7
Carbon trading (EU ETS) €	12.9	-3.1	-20.1	-20.3

*Total return index. †New series. ‡Credit-default swap spreads, basis points.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac. §Jun 16th

US corporate defaults

Jun 18th 2009
From The Economist print edition



The global recession is spurring a huge increase in corporate defaults. In the week to June 11th seven firms in America defaulted on their debt, pushing the total to 109 so far this year. Standard & Poor's (S&P), a rating agency, predicts that figure will rise to 209 by the end of the year, an increase of 117% from 2008 and 36 more than in 2001 when the dotcom bubble burst. Record issuance of speculative- grade bonds and the widespread use of debt to finance the repurchase of firms' own shares made defaults more likely. As troubling as the level of defaults is the fact that S&P gave 43% of defaulting firms worldwide a recovery rating of 6, meaning that creditors can expect to get back less than 10% of the value of their bonds.